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AUTHORIZATIONS FOR THE SECURITIES AND EXCHANGE COMMISSION

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

SECURITIES AND EXCHANGE COMMISSION
REAUTHORIZATION REQUEST FOR APPROPRIATIONS
FOR FISCAL YEARS 1984 THROUGH 1986

MARCH 25, 1983

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AUTHORIZATIONS FOR THE SECURITIES AND EXCHANGE COMMISSION

FRIDAY, MARCH 25, 1983

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Securities,
Washington, D.C.

The subcommittee met at 9:30 a.m., in room 538, Dirksen Senate Office Building, Senator Alfonse M. D'Amato (chairman of the subcommittee) presiding.

Present: Senators D'Amato, Sarbanes, and Proxmire.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'Amato. Good morning. This is the Senate Banking Committee's Subcommittee on Securities and we are delighted to have Chairman John Shad who liked testifying so much that he is doing it twice this week.

As you know, the focus of today's hearing is the Securities and Exchange Commission's reauthorization for fiscal years 1984 through 1986. As I've said in the past, I think the SEC is an outstanding agency. That's not only my opinion but the opinion of Senator Proxmire, Senator Garn, and all the other members of the Banking Committee.

The SEC regulates the securities industry and is responsible for insuring that issuers provide adequate disclosure in order for investors to make informed investment decisions. It also monitors the markets to protect investors from fraud and other market abuses.

The Commission keeps our capital markets operating smoothly and provides an efficient means for our businesses to raise the capital that is so vital to our economic system.

On the whole, the SEC is to be commended for the manner in which it has fulfilled its responsibilities. In the years since the last authorization request in 1980, the volume of shares traded on the exchange and over-the-counter issues have increased by 82 percent. The number of shareholders has increased 13 percent. The number of registered broker-dealers has grown 20 percent, and the number of investment companies has grown by some 37 percent.

Over the coming years the Commission foresees continued growth in corporate demand for outside sources of funds, new participants entering the securities industry, and a trend toward extremely large mergers, all of which will exert an increasing strain on Commission resources.

The issue before us today is to consider the SEC's request for reauthorization in light of the Commission's future workload. I'm hopeful that today's hearing will provide the committee members with the background necessary to consider the SEC's authorization for fiscal years 1984 through 1986, and then give us a general oversight in regard to this matter.

Commissioner Shad, we're delighted to hear from you once again.

STATEMENT OF JOHN S. R. SHAD, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. **SHAD**. Thank you, Chairman D'Amato.

Chairman D'Amato and members of the subcommittee, the Securities and Exchange Commission appreciates this opportunity to request reauthorization. The Commission's present 3-year authorization expires this year.

Reauthorization is requested for appropriations in the amount of $99.1 million for fiscal 1984; $107.6 million for fiscal 1985; and $117.7 million for fiscal 1986.

It is requested that the two formal statements previously submitted be made a part of the record.

Senator **D'AMATO**. Without objection, so ordered.

[Complete statements follow:]

STATEMENT OF JOHN S.R. SHAD,
CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION,
TO THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

March 25, 1983

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CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION, TO THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

March 25, 1983

Chairman D'Amato and Members of the Subcommittee:

Overview of Fiscal 1982 Results and Ongoing Efforts

The Securities and Exchange Commission appreciates this opportunity to present an overview of its fiscal 1982 activities and ongoing efforts. A separate reauthorization request for 1984-1986 has also been submitted. It is requested that these statements be made part of the record.

The Commission's present three-year authorization expires this year. An additional three-year authorization is requested for appropriations in the amount of $99.1 million for fiscal 1984, $107.6 million for fiscal 1985, and $117.7 million for fiscal 1986.

The Commission has attempted to fulfill its responsibilities in the most effective and efficient manner. Many of the actions taken in 1982 as well as initiatives now in progress, which are described more fully in the following detailed statement, reflect the Commission goal of assuring that the focus of Commission resources is on those policies and issues most important to investor protection.

Fiscal 1982

Briefly, in fiscal 1982 the Commission brought 31% more enforcement cases, conducted 26% more investment company and adviser inspections, processed 8% more broker-dealer reports and handled 5% more full disclosure filings, than in fiscal 1981, with 5% less personnel. Registration and other fees offset 94% of the Commission's $83 million budget, as compared with 81% in fiscal 1981.

The following were records -- or the highest level in several years -- despite significant personnel reductions over the years: 251 enforcement cases were brought, 1,065 investment company and adviser inspections were conducted, 6,599 broker-dealer reports were processed, 65,000 full disclosure filings were handled, and $78 million of registration and other fees were collected. The Commission also processed about 17,000 public complaints. The staff of 1,882 was at the lowest level in several years.

Securities and Exchange Commission

	Fiscal Years		Percentage Change
	1981	1982	
Enforcement Cases	191	251*	+ 31%
Investment Company and Adviser Inspections	848	1,065*	+ 26%
Broker-Dealer Reports	6,106	6,599*	+ 8%
Full Disclosure Filings	62,000	65,000*	+ 5%

Total Staff-years	1,982	1,882†	- 5%
Public Complaints°	21,000	17,000†	- 19%
Fees Received as a Percent of the SEC Budget	81%	94%*	

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* - A record or the highest level in several years.

† - The lowest level in several years.

° - Estimates due to shift from manual to computer tabulation.

Reasons

Some of these results are due to continuing improvements in management techniques and automation, such as computer and data processing aids in filing reviews -- and in screening investment advisers for inspection -- and the Case Analysis and Tracking System for weekly enforcement case reviews.

Simplification of corporations' filings have reduced expenses ultimately borne by their shareholders, as well as the Commission's paperwork.

The increase in fees to 94% of the budget was principally due to the growth of money market funds -- which are now contracting.

However, the principal reason for the excellent fiscal 1982 results is the outstanding SEC staff, which the Heritage Foundation recently characterizes in a new book on regulatory reform as "among the best and brightest in the government."

The following are highlights of major fiscal 1982 programs and ongoing efforts.

Enforcement

Enforcement is the largest activity at the Commission. It accounts for about a third of the total budget. The Commission has received substantial cooperation from the business and financial community in its efforts to expose and sanction those who would impugn the integrity of the world's best securities markets.

The 251 enforcement cases brought in fiscal 1982, compare with 191 in fiscal 1981, despite budgetary constraints and personnel reductions. Nearly 60% (145) of these cases were injunctive actions (including nine civil and criminal contempt proceedings). The Commission obtained injunctions against 327 defendants in 133 enforcement actions in fiscal 1982 compared to injunctions against 312 defendants in 125 actions in fiscal 1981. The balance of the 1982 enforcement actions (106) were administrative proceedings.

Of the 251 cases, about 45% (117) involved violations by regulated entities and individuals, nearly 20% (47) concerned securities distribution violations, 15% (36) financial statement and reporting violations, and 12% (31) market manipulation and other violations. While insider trading cases received high visibility, they only amounted to 8% (20) of the total.

The 20 insider trading cases represent 40% of all such cases brought in the past five years. The fiscal 1982 cases also include ten cases brought under the accounting provisions of the Foreign Corrupt Practices Act ("FCPA") (which represents over 40% of all FCPA cases brought since the FCPA was enacted in 1977). Three 21(a) reports on important investigations were also published.

Disgorgements

The Commission obtained illicit gain disgorgements and restitutions of $33 million, rescission offers and refunds to investors of $53 million and asset freezes to protect investors of $37 million. Comparable data are not available for fiscal 1981.

Swiss Accord

The Accord concluded with Switzerland removed the haven of Swiss secrecy laws from those who would trade on inside information. It is also an important precedent for greater international cooperation in the maintenance of fair and orderly markets.

Integration

In the interest of shareholders, integration of the registration and reporting requirements under the 1933 and 1934 securities acts increased their corporations' financing flexibility and reduced their expenses by over $350 million dollars per annum, without compromising full disclosure. Integration has also reduced the Commission's paperwork.

Net Capital Rule

The securities industry's net capital and other requirements were updated to take into account the industry's improved financial and operational condition. Larger discounts were imposed on bond holdings for net capital purposes in response to the greater volatility of these markets. However, the net result was that over $500 million of securities industry capital was freed-up for more efficient employment. Such capital has helped the industry handle the much greater breadth and depth of the securities markets since August and improve other services to investors.

Registration Exemptions

In the interest of small business shareholders, certain securities offerings -- up to $5 million to other than the general public -- were exempted from registration, which will reduce small businesses' expenses by about $50 million per annum. Such financings are expected to exceed $4 billion this fiscal year. Private placement exemptions were also simplified and improved, in a manner consistent with investor protection. These exemptions also reduce the Commission's paperwork. Most states are expected to adopt comparable exemptions -- which will be the first joint state and federal registration exemptions.

SEC/CFTC Accord

The Accord concluded with the Commodity Futures Trading Commission resolved a seven-year jurisdictional dispute and enabled the SEC to authorize trading in Treasury, GNMA, foreign currency, certificate of deposit and stock index options. These new options will facilitate government and mortgage financings, international trade and hedging the risks of fluctuating interest rates and securities markets.

Investment Companies

Rules were adopted which permit the automatic effectiveness of certain routine investment company filings. The Commission is also soliciting comments on proposals to simplify and improve investment company prospectuses and to eliminate the need for certain insurance company separate account exemptions. These measures reduce expenses ultimately borne by investors, and the Commission's paperwork, in a manner consistent with investor protection.

Proxies, Communications and Releases

Comments have been solicited on proposed improvements in the proxy rules. Others are in prospect. Progress is also being made in facilitating corporations' ability to communicate with their shareholders, despite the high percentage of securities registered in nominee names - and in simplifying and improving SEC releases. These measures will benefit investors and reduce their corporations' expenses and the Commission's paperwork.

Accounting Regulations

A number of redundant or outmoded Accounting Series Releases were withdrawn and the balance were simplified and codified in a ready-reference manual. These measures also reduce expenses ultimately borne by shareholders, and the Commission's paperwork, in a manner consistent with investor protection.

Self-Regulation

Greater reliance is being placed on private-sector self-regulation, under the SEC's oversight. Effective self-regulation results in greater investor protection and lower Commission expenses.

For example, under the auspices of the American Institute of Certified Public Accountants, the 428 accounting firms which audit over 90% of publicly owned corporations are now on a three-year peer review cycle. The purpose of these reviews is to assure high auditing standards. They also "pay for themselves" by reducing auditors' risks of liabilities to those who rely on their audits. These reviews are carefully monitored by the Office of the Chief Accountant.

Market Surveillance

In addition, at the Commission's initiative, the stock exchanges and the over-the-counter markets are enhancing their electronic market surveillance systems and transaction audit trails, under the oversight of the Market Regulation Division. In addition to exposing possible manipulation and insider trading, audit trails reduce securities firms' transaction reconciliation costs.

Shelf Registration Rule

As part of the integration process, the shelf registration rule has been adopted on a temporary basis. This rule permits corporations to file a single registration statement covering securities they expect to sell from time to time within two years.

Over 2,200 shelf registration statements have been filed since March, 1981. Nearly 90% have been traditional shelf filings. Most of the balance have been investment grade debt filings, which amount to over 60% of the $70 billion of total debt issues. Equity shelf filings amount to only 3% of the $90 billion of total equity filings filed in March through December. The Commission will review the rule later this year, to determine whether to extend, modify or withdraw it.

National Market System

With reference to the National Market System, the exchange and over-the-counter markets in 30 stocks were linked in May.

This experiment is being closely monitored by the Commission and the securities industry. To date, there has been a slight improvement in the price continuity of transactions in these stocks.

Order exposure principles, proposed by the Securities Industry Association-DeNunzio committee, have been released for public comment.

Transactions in 84 national market system over-the-counter stocks are now being reported on a real time basis. The number was increased to 184 on February 9, 1983.

The Intermarket Trading System ("ITS") volume has increased from 102 million shares five years ago to 825 million in 1982. The Commission recently converted ITS from a temporary to a permanent status.

Conferences

The SEC is also spending more time listening to investors, corporations and others. In 1982, the Commission held:

- the first Research Forum - at which 40 leading securities analysts and others recommended improvements in the SEC's disclosure and rulemaking practices;
- the first Government-Business Forum on Small Business Capital Formation, under the Small Business Investment Incentive Act;

- a conference on major issues confronting financial institutions and markets in the 1980s; and
- an international conference with securities regulators and others from 31 nations.

The Commission has also held the first round of meetings with other federal agencies with which it has overlapping jurisdication (the Commodity Futures Trading Commission, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Home Loan Bank Board).

Task Force

In congressional testimony and speeches, the Commission has advocated for over a year the formation of a task force to review and submit to Congress measures to simplify and improve the regulatory structures of the financial service industries and capital markets, for the benefit of investors and depositors. Vice President Bush recently announced formation of a task force for this purpose.

Regulatory Reform

This year, the Senate and House Banking and other interested Committees in Congress will continue to hold hearings on matters which relate to the capital markets and securities laws. Vice President Bush's Task Group on the Regulation of Financial Services is expected to make proposals.

The Commission expects to participate in such hearings and deliberations.

Litigation

There are also a number of important cases pending, which may significantly impact the securities laws: the Dirks inside information case; several implied right of action cases, including Chemtron, Liberty National Insurance and San Francisco Real Estate Investors; and Dickinson, a 13(d) enforcement case; to name a few. Recently, in the Huddleston case the Supreme Court endorsed the Commission's position that the existence of private rights of action under the Securities Act of 1933 does not nullify implied rights of action under the Securities Exchange Act of 1934. The Commission is a party or has filed amicus briefs in these cases and many others.

Legislation

The Commission requests the Subcommittee's support of proposed legislation to increase criminal fines for certain securities violations and to permit civil fines of up to three times illicit insider trading profits. The Commission has also proposed repeal of the Public Utility Holding Company Act, and testified in support of the Glass-Steagall, Foreign Corrupt Practices and Bankruptcy Reform Act amendments. In addition, the Commission seeks passage of legislation to require all over-the-counter broker-dealers to join a registered self-regulatory organization; to expand the number of individuals eligible to serve as a "public representative" on the Municipal Securities Rulemaking Board; to permit the Commission to accept travel reimbursements; and to permit employers to pay Commission Fellows' relocation costs.

Tenders, Remedies and Markets

During the coming year, the Commission will also be studying the tender offer rules and the underlying assumptions of the Williams Act, the adequacy of the SEC's enforcement remedies, and the rapidly changing domestic and international securities markets, in order to be sure that its efforts are being focused where they will best serve investors.

DETAILED DISCUSSION

Enforcement Program

The Commission maintains a comprehensive enforcement program in order to address promptly violations of the Federal securities laws. The program must be capable both of promptly responding to emergency threats to investors and of anticipating emerging problems.

The enforcement program deploys about a third of the Commission's total resources. In fiscal 1982, the Commission brought 251 cases, a 31% increase over fiscal 1981, despite budgetary constraints and personnel reductions. A key factor was careful review to ensure that cases and investigations were developed and completed without unnecessary delays, including use of the computer-based Case Analysis and Tracking System.

The 145 civil injunctive actions brought (including nine civil and criminal contempt proceedings) were a 22% increase over 1981. They included nine civil and criminal contempt proceedings. Administrative proceedings increased 47% to 106 cases. Three reports of investigation under Section 21(a) of the Securities Exchange Act of 1934 ("Securities Exchange Act") were published.

The Commission obtained injunctions against 327 defendants in 133 enforcement actions in FY 1982 compared to injunctions against 312 defendants in 125 injunctive actions in FY 1981.

1. Commission Remedies

The federal securities laws provide civil and administrative remedies designed to rectify past violations and prevent future violations. The Commission's principal enforcement remedy is a Federal court injunction, ordering a defendant to comply with the law in the future. Violation of the injunction may result in contempt proceedings. In fiscal 1982, 136 injunctive actions named 418 defendants.

In addition, in civil injunctive actions courts often enter orders for other equitable relief such as restitution, disgorgment of illicit profits, or other relief appropriate to the particular case. The Commission obtained court orders in fiscal 1982 that required defendants to divest illicit profits of $33 million, either as disgorgement or as restitution to defrauded investors. Another $53 million was the subject of orders for rescission of transactions or the refunds to investors. Emergency actions brought by the Commission led to freeze orders by courts that protected $37 million in investor funds until a disposition of the funds could be made.

The Commission regulates certain entities, such as broker-dealers, investment companies and investment advisers. If regulated entities violate the federal securities laws or regulations, they may be censured or have their registrations suspended for up to 12 months or revoked in an administrative proceeding. An effective registration is needed to stay in business. During fiscal 1982, the Commission revoked the registration of 11 firms, suspended 9 and censured 28, compared to 7 revocations, 7 suspensions, and 23 censures in 1981.

Administrative proceedings may also be instituted against persons associated with regulated entities. The remedies include censure, suspension for up to 12 months or a bar from participation in the securities industry. The Commission barred 44 individuals, suspended 82, and censured 19 in fiscal 1982, compared to 23 bars, 50 suspensions, and 17 censures, a year earlier.

Issuers may be subject to administrative proceedings pursuant to Section 15(c)(4) of the Securities Exchange Act if they fail to comply in a material respect with the Act's disclosure requirements. They may be ordered to comply upon specified terms and conditions. Five such proceedings were instituted in fiscal 1982, nine in fiscal 1981.

Criminal sanctions for federal securities law violations include fines and imprisonment. In fiscal 1982, 47 defendants were named in 24 criminal indictments or informations relating to Commission investigations, compared to 48 and 26 in fiscal 1981. In addition, more than $450,000 in criminal fines were imposed. The Commission assisted state and local authorities and self-regulatory organizations in enforcement efforts and also received their assistance. In order to raise the level of skill and knowledge of our enforcement staff, we periodically hold an enforcement training program. Over 50 representatives of state, federal and foreign agencies attended the Commission's 1982 three-day training program.

2. Swiss Accord

Commission investigations of suspected insider trading have sometimes been impeded by foreign secrecy laws or blocking statutes. On August 31, 1982, significant progress was made in this area when the governments of Switzerland and the United States concluded six months of negotiations with the signing of a Memorandum of Understanding concerning nation-to-nation law enforcement cooperation in insider trading cases. 1/ The Memorandum contains: (a) an exchange of opinions which clarifies the ability of the Commission to use the 1977 Treaty between the United States and Switzerland concerning mutual assistance in criminal matters in its investigations of insider trading; (b) an agreement in principal to exchange certain diplomatic notes; and (c) understandings with respect to an agreement between members of the Swiss Bankers Association which will permit signatory banks, under certain circumstances, to furnish information and evidence to the Commission through the Swiss Federal Office for Police Matters, notwithstanding Swiss secrecy laws.

3. Insider Trading

Insider trading (the purchase or sale of securities by persons in possession of material, non-public information relating to such securities) undermines the expectation of fairness and honesty that is the basis of public confidence in the nation's securities markets. The proliferation of tender offers and the advent of trading in standardized options contracts have increased opportunities for those with material non-public information to reap large profits.

1/ "Swiss and U.S. Governments Sign Memorandum of Understanding", Press Release No. 82-44,82 SEC News Digest 169 (September 1, 1982).

In response, the Commission has increased its efforts to combat this threat to the integrity of the securities markets. In fiscal 1982, the Commission brought 20 insider trading actions (including the publication of a report pursuant to Section 21(a) of the Securities Exchange Act). 2/ While these actions constituted only 8% of the total cases brought, they compare with a total of approximately 50 such actions brought since 1977, and 97 since 1949. The cases involved corporate executives, attorneys, accountants, bank officers and others who allegedly obtained confidential information concerning proposed tender offers, or other significant developments, in the course of their work.

4. The Insider Trading Sanctions Act

In September 1982, the Commission sent to Congress a legislative proposal to impose new sanctions on persons who violate the Securities Exchange Act by purchasing or selling a security while in possession of material nonpublic information in a transaction (i) on or through the facilities of a national securities exchange or firm or through a broker or

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2/ *E.g.*, *SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for, the Common Stock of Santa Fe International Corporation, et al.*, Civ. Act. No. 81-6553 (S.D.N.Y.), Litigation Release Nos. 9484, 9485 (October 26, 1981), 1379, Litigation Release No. 9770 (September 29, 1982); and *SEC v. Gary L. Martin, Martin, M & M Investment and Gary L. Martin, Inc., P.S.*, Civ. Act. No. C-82-81 (W.D. Wash.), Litigation Release No. 9642 (April 7, 1982).

dealer, and (ii) which is not part of a public offering by an issuer of securities other than standardized options. Specifically, the legislation would: (1) allow the Commission to seek civil monetary penalties of up to 300 percent of the insider's trading profits; and (2) increase the maximum criminal fine for most violations of the Securities Exchange Act from $10,000 to $100,000. The penalty, payable to the Treasury, could be imposed on aiders and abettors as well as primary violators. The legislation would authorize the Commission to exempt, by rule or regulation, any class of persons or transactions from the scope of the statutory provisions. The legislation was introduced in the 97th Congress, and it has recently been reintroduced in the House by Chairman Dingell as H.R. 559, the Insider Trading Sanctions Act of 1983.

5. Corporate Reporting and Accounting

The Securities Exchange Act and Commission rules require periodic and timely disclosure of information by publicly owned companies. Recently, problems associated with reduced profits and high interest rates have demanded more attention to the adequacy of reports of financial condition and business operations by companies that file with the Commission. Accordingly, the detection and correction of materially inadequate or inaccurate reports is a high priority.

Financial disclosure violations may involve improper valuation of inventories, assets or liabilities, the remuneration of officers and other related parties, the ability of a corporation to meet its obligations or the recognition of revenue and expenses. Violations with respect to nonfinancial information may include such things as material misstatements concerning corporate mineral reserves or production or a failure to disclose relevant facts concerning corporate management.

Closely related to the emphasis on fraud by reporting companies is enforcement of the accounting provisions of the Foreign Corrupt Practices Act of 1977 (Section 13(b)(2) of the Securities Exchange Act). These provisions require issuers to make and keep accurate books and records and to devise and maintain systems of internal accounting controls which provide reasonable assurances that certain statutory objectives are met. The requirements are intended to assure that issuers have reliable financial information with which to prepare financial statements and other disclosure documents.

Thirty-six issuer financial statement and reporting cases were brought in 1982, 3/ including 10 alleged violations of the accounting requirements of the FCPA. 4/ This is 40%

3/ *E.g.*, *SEC v. Data Access Systems, Inc., et al.*, Civ. Act. No. 81-3362 (D.N.J.), Litigtion Release No. 9487, (October 29, 1981); and *SEC v. Hotel Associates of Atlantic City, et al.*, Civ. Act. No. 82-721 (D.N.J.), Litigation Release No. 9612, (March 11, 1982).

4/ *E.g.*, *SEC v. William R. Bundy*, Civ. Act. No. IP 81-1350 (S.D. Ind.), Litigation Release No. 9532 (December 18, 1981); and *SEC v. Computer Communications Inc., et al.*, Civ. Act. No. 81-2490 (D.D.C.), Litigation Release No. 9472 (October 19, 1981).

of the 24 FCPA actions brought between enactment of the statute and the end of the fiscal year. Nine delinquent filing actions were also included in this category.

6. Market Manipulation

The Commission is charged with ensuring the integrity of trading on the national securities exchanges and in the over-the-counter markets. The Commission's staff, and the exchanges and the National Association of Securities Dealers ("NASD") under the Commission's oversight, engage in surveillance of these markets. Ten manipulation actions were brought in fiscal 1982. 5/ They involved attempts to create the appearance of trading activity through nominee accounts, the use of confederates to make artificial trades and unauthorized trading of customer accounts to prevent price declines.

7. Related Party Transactions

Fundamental to the relationship between an investor and management is the expectation that a company's assets will be used for the benefit of the company and not for the personal benefit of its managers. Accordingly, the Commission's rules require disclosure of transactions by companies with management or related parties. In four actions, the Commission

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5/ E.g., SEC v. James T. Hinz, Civ. Act No. 82-0401 (E. D. Wisc.), Litigation Release No. 9638 (April 2, 1982); and SEC v. Gary V. Lewellyn and G. V. Lewellyn & Co., Civ. Act. No. 2102 (S.D.N.Y.), Litigation Release No. 9639 (April 2, 1982), Litigation Release No. 9673 (May 14, 1982).

alleged that company officials failed to disclose benefits received in related party transactions.

8. Securities Distribution Violations

Some issuers fail to register public offerings of their securities or rely on purported exemptions which are not available to them. Distribution violations may also include fraudulent material misrepresentations or omissions in connection with securities offerings.

In fiscal 1982, 47 enforcement actions involved securities distribution violations. 6/ The Commission also published a report pursuant to Section 21(a) of the Securities Exchange Act which emphasized the Commission's concern with respect to disclosure issues raised in connection with the offer and sale of securities in the form of retail repurchase agreements, and reminded thrift institutions and banks of their disclosure obligations under the federal securities laws. 7/

9. Changes in Corporate Control

Sections 13 and 14 of the Securities Exchange Act govern the activities of persons and entities involved in gaining,

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6/ E.g., SEC v. James L. Douglas a/k/a James L. Cooper, Civ. Act. No. C82-29 (N.D. Ohio), Litigation Release No. 9589 (February 19, 1982); and SEC v. Flow General Inc., Civ. Act. No. 82-1344 (D.D.C.), Litigation Release No. 9674 (May 17, 1982).

7/ In the Matter of Fidelity Financial Corporation and Fidelity Savings and Loan Association, Securities Exchange Act Release No. 18927 (July 30, 1982).

or attempting to gain or maintain control or ownership of a corporation. These provisions govern proxy solicitations and the filing of reports by persons or groups who make a tender offer or acquire beneficial ownership of more than 5% of a class of equity securities registered with the Commission These requirements are intended to ensure that investors have the material information needed to make informed investment or voting decisions. Nine enforcement actions were brought in this area during fiscal 1982. 8/

10. Regulated Entities and Associated Persons

Fiscal 1982 actions involving regulated entities (including broker-dealers, investment companies and advisers) ranged from books and records violations to attempts to defraud customers. A number of cases included allegations that broker-dealers failed adequately to supervise their employees. Three actions involved alleged "money laundering" activities, including the failure to file currency transaction reports as required by Internal Revenue Service regulations for cash transactions in excess of $10,000.

8/ E.g., SEC v. Severyn Ashkenazy, Civ. Act. No. 82-1799 (C.D. Cal.), Litigation Release No. 9645 (April 13, 1982), 25 SEC Docket 2129; and SEC v. Bayswater Realty & Capital Corporation, et al., Civ. Act. No. 81-3203 (D.D.C.), Litigation Release No. 9540 (December 30, 1981), 24 SEC Docket 597.

Fiscal 1982 broker-dealer cases totalled 82. 9/ The Commission also brought 35 other regulated entity cases, which included violations by investment companies and advisers and fraud upon regulated entities by their customers. 10/ The Commission also published one related report pursuant to Section 21(a) of the Securities Exchange Act.

11. "Hot Issues" Task Force

"Hot issues" market problems in the Denver area included manipulation, financial responsibility and recordkeeping violations by broker-dealers. A task force of 50 people drawn from Washington, each regional office and the NASD conducted examinations of 30 "hot issue" broker-dealers in February 1982. Injunctive actions were filed against five broker-dealers, three of which were placed under the supervision of Securities Investor Protection Corporation receivers. Eleven other firms voluntarily closed for a period of time, five of which have been or are being liquidated.

9/ E.g., In the Matter of Bache Halsey Stuart Shields, Inc., et al., Securities Exchange Act Release No. 19003 (August 24, 1982); and SEC v. Larry D. Blavin, Civ. Act No. 81-74281 (E.D. Mich.), Litigation Release No. 9506 (November 18, 1981).

10/ E.g., In the Matter of CMC Funding, Ltd., Investment Advisers Act Release No. 822 (September 1, 1982); In the Matter of Government Securities Management Company, Inc., Investment Advisers Act Release No. 814 (July 21, 1982), 25 SEC Docket 1244; and SEC v. Martin and David Rosenberg, Civ. Act. No. 82-6184 (S.D.N.Y.), Litigation Release No. 9759 (Sept. 24, 1982).

12. Foreign Corrupt Practices Act

In 1982, and recently, the Commission supported amendments that would amend and clarify the accounting provisions of the FCPA in order to reduce uncertainty and compliance burdens. The accounting provisions require that issuers make and keep accurate books and records and devise and maintain systems of internal accounting controls which provide reasonable assurances that certain statutory objectives are met. These provisions are intended to assure that issuers have reliable information with which to prepare financial statements and other disclosure documents.

The Commission also has responsibility for civil enforcement of the anti-bribery provisions of the FCPA. These prohibit the corrupt use of payments or gifts to officials of foreign governments and certain other persons in order to obtain or retain business. In testimony submitted to the Congress, the Commission stated that it did not object to proposals that enforcement of the anti-bribery provisions of the FCPA be consolidated in the Department of Justice.

13. Access to Business Records in the Commission's Possession

In the course of carrying out its responsibilities to enforce the federal securities laws, the Commission receives a great deal of information from or concerning those under investigation that is neither required to be filed with the

Commission nor publicly available from the companies or individuals involved. There have been repeated efforts to force public disclosure of these records under the Freedom of Information Act ("FOIA"), frequently over the vigorous objections of the persons who furnished this information to the Commission. 11/ Substantial Commission time and expense have gone into determining which of these records are exempt from disclosure under the FOIA and which are not. Similarly, corporations have incurred substantial legal fees and other costs in seeking to demonstrate to the Commission that it is justified in withholding particular documents from FOIA requestors.

The Commission must carefully weigh competing interests in fulfilling its obligations to disclose records to the public under the FOIA. At the same time, the Commission has

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11/ A number of lawsuits seeking access to these records under the Freedom of Information Act have been filed against the Commission and law enforcement agencies which reviewed these corporate records from the Commission. Of particular note is the litigation brought by Dow Jones Corporation, the owner of the Wall Street Journal, against the Commission, the Department Justice, and the Department of State, seeking access to all records relating to questionable corporate payments and the Commission's voluntary disclosure program. Dow Jones, Inc. et al. v. SEC, et al., (No. 79-1238, D.D.C., filed March 4, 1977). These records relate to over 500 corporations, many of which are requesting confidential treatment for these records, including a large number which are non-public and were provided to the Commission in confidence. And, some corporations have intervened in litigation to protect their interests directly.

an obligation to preserve the legitimate confidentiality of the corporations and individuals who submit information to the Commission. The primary purpose of the FOIA was to ensure public access to information in the possession of the government so that the public could see whether the laws were being administered properly. But, it has been the Commission's experience that the FOIA is frequently utilized by competitors, litigants, and other adversaries to those who have submitted the Commission's investigatory files as a means of discovering sensitive information which may afford a business or other advantage over the submitter of information. While FOIA Exemption 4 permits the Commission to withhold trade secrets and certain other confidential business and financial information, the courts have construed that exemption rather narrowly. 12/

Moreover, in many cases, Commission investigation reveals no need to bring enforcement action against particular individuals or businesses who have come under inquiry. Unfortunately, however, the FOIA is unclear concerning whether closed investigatory records may be protected from disclosure, despite the fact that no actionable wrongdoing

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12/ See e.g., Board of Trade of the City of Chicago v. Commodity Futures Trading Commission, No. 78-1089, (D.C. Cir., May 13, 1980); National Parks and Conservation Association v. Morton, 498 F.2d 765 (D.C. Cir. 1974).

was discovered and public revelation of the fact of investigation may seriously injure and embarrass those involved. 13/ This latter problem has been particularly acute with respect to the Commission's foreign payments files.

On June 16, 1981, the Commission testified before the Senate Banking Committee on proposed amendments to the Foreign Corrupt Practices Act. Among the amendments the Commission recommended was one that would exempt from the FOIA records relating to closed investigations. The proposed amendment to Section 24 of the Securities Exchange Act, which is substantially identical to recent legislation applicable to investigation files of the Federal Trade Commission, reads:

> "any materials which are received by the Commission in any investigation or inquiry permitted by the federal securities laws as defined in Section 21(g), or the rules and regulations adopted thereunder, and which is provided pursuant to any compulsory process under this Act or which is provided voluntarily in place of such compulsory process shall be exempt from disclosure under Section 552 of title 5, United States Code."

The Commission continues to support this amendment. Because this revision relates only to Section 24 of the Securities Exchange Act and the definition of records contained therein, it would not effect a direct change in the FOIA

13/ Of course, this concern would not apply to information which has become public knowledge in the course of judicial or administrative proceedings.

itself or in the information disclosure practices of any other federal agency.

Other Litigation

The Commission is involved in a substantial amount of litigation other than the enforcement program litigation conducted by its Division of Enforcement. This other litigation is conducted by the Office of the General Counsel. It consists of both all Commission appellate litigation and some trial court work. In fiscal year 1982, the Office of the General Counsel handled 251 litigation matters.

Commission appellate litigation involves primarily appeals from district court decisions in enforcement matters and petitions seeking appellate review of Commission rulemaking and administrative decisions. The Office of the General Counsel handled 62 appeals from district court decisions in enforcement matters and 38 appeals from Commission rulemaking and administrative decisions during the fiscal year. Of the 55 matters that were concluded during the year, only five were resolved unfavorably to the Commission. The Office of the General Counsel also represents the Commission, at both the trial and appellate levels, when the Commission presents its views, as friend of the court, on significant securities law issues in civil litigation involving private parties. The Commission presented its views as friend of the court in 58 instances in fiscal year 1982. The Office of the General

Counsel also defends the Commission in suits brought against it under federal procurement, equal employment, and other statutes such as the Freedom of Information Act.

The Commission's Annual Report to Congress will provide additional statistical and other information on litigation handled by the Office of the General Counsel. The following discussion covers only a few of the significant cases handled recently by the Office.

One issue that has arisen fairly frequently over the years in securities law litigation, the scope of the term "security," has recently occupied our time once again. The issue is an important one because its resolution helps to delimit the jurisdiction of the Commission and the scope of the protection offered by the federal securities laws.

In Marine Bank v. Weaver, 14/ the Supreme Court in early 1982 ruled that a certificate of deposit issued by a federally-regulated bank whose deposits were insured by a federal agency was not a security subject to the antifraud provisions of the federal securities laws. In so ruling, the Court agreed with the position taken by the Commission in a brief submitted in conjunction with the federal bank regulatory agencies. Our position was that it is unnecessary to subject certificates of deposit issued by banks that are

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14/ 102 S. Ct. 1220 (1982).

federally insured and subject to the comprehensive regulatory scheme of the federal banking laws to the antifraud provisions of the federal securities laws, since under those circumstances there is abundant protection for holders of the certificates. Consistent with the Commission's position, the Court left open the possibility that certificates of deposit might be considered securities in some contexts.

The Commission has also participated recently as friend of the court in several private actions where the issue was whether a controlling stock interest in a business constitutes a "security" for purposes of the federal securities laws. 15/ The Commission took the position that such interests are securities and that application of the federal securities laws should not depend on whether a purchaser of stock buys a small interest or a controlling interest in a corporation.

In Chicago Board of Trade v. SEC, 16/ the United States Court of Appeals for the Seventh Circuit had overturned a Commission order approving trading in options on Government National Mortgage Association securities on the grounds that GNMA options are not securities under the federal securities

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15/ These actions were: Daily v. Morgan, No. 82-4077 (5th Cir.); Seagrave Corp. v. Vista Resources, Inc., No. 82-7238, slip op. (2d Cir. Dec. 27, 1982); Landreth Timber Co. v. Landreth, No. 81-3446 (9th Cir. 1982) Golden v. Garafalo, 678 F.2d 1139 (2d Cir. 1982).

16/ 51 U.S.L.W. 3405 (Nov. 23, 1982), vacating as moot 677 F.2d 1137 (7th Cir. 1982).

laws. As the Subcommittee will recall, Congress enacted legislation dealing with this issue after the Commission sought Supreme Court review of the Court of appeal's decision. The legislation, discussed in more detail below, makes it clear that options on securities are separate securities and that the Commission has authority to regulate them. It also clarifies the status of certificates of deposit as securities.

The Office of the General Counsel has also participated in several significant cases involving the extent of redress available for violations of the federal securities laws. For instance, the Commission submitted a brief in support of the position that the Supreme Court ultimately adopted in the case of Herman & MacLean v. Huddleston 17/ -- that a defrauded purchaser of registered securities can maintain an action under both Section 11 of the Securities Act, which provides for civil liability for false registration statements, and Section 10(b), the "catchall" antifraud provision of the Securities Exchange Act.

The Commission has also participated as friend of the court in several private cases to urge that a private right of action for injunctive and other equitable relief is available under Section 13(d) of the 1934 Act, which requires that persons in a position to effect changes in control of a

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17/ No. 81-680, slip op. (Jan. 24, 1983).

company disclose certain information. 18/ Finally, the Commission has attempted in litigation to expand the circumstances under which a wrongdoer under the securities laws should be required to surrender the profits of his wrongdoing, which often may then be made available to defrauded investors. 19/

In Dirks v. SEC, 20/ the Commission obtained an affirmance from the United States Court of Appeals for the District of Columbia Circuit of its censure of a securities analyst for selectively releasing to institutional investors material inside information concerning widespread fraud within a publicly-traded company. The institutional investors had sold over $17 million in the company's securities, which became worthless soon after the fraud was exposed publicly. The case is currently pending before the Supreme Court.

18/ E.g., Liberty National Insurance Co. v. the Charter Co., No. 82-7260 (11th Cir. 1982); San Francisco Real Estate Investors v. Real Estate Investment Trust of America, No. 82-1853 (1st Cir. 1982); The Hanna Mining Co. v. Norcen Energy Resources Corp., [1982] Fed. Sec. L. Rep. (CCH) ¶98,742 (N.D. Ohio 1982), appeal dismissed, No. 82-3386 (6th Cir. 1982).

19/ Cases in which the Commission made such attempts included Sec v. MacDonald, Nos. 81-1356, 81-1513, 81-1514 (1st Cir. 1982) and Sec v. Washington County Utility Dist., 676 F.2d 218 (6th Cir. 1982).

20/ 681 F.2d 824 (D.C. Cir. 1982), cert. granted, 51 U.S.L.W. 3140 (Aug. 17, 1982) (No. 82-276).

Regulatory Reform

This year, the Senate and House Banking and other Committees are expected to hold hearings on matters which relate to the capital markets and financial service industries, and Vice President Bush's Task Group on the Regulation of Financial Services is expected to submit proposals to Congress. The Commission expects to participate in such hearings and deliberations.

Major Issues Conference

On October 19, 1982, the Commission held a three-day conference on major issues confronting the nation's financial institutions and markets in the 1980s. The topics discussed were: regulation of financial institutions and markets in the 1980s; self-regulation v. government regulation of financial institutions; disclosure and enforcement problems; structure of the securities markets; and investment management regulation. Moderators and panelists were high-level officials of the securities and depository institutions regulatory agencies and leading members of the financial services industries. The conference was attended by 550 representatives of those industries and other interested persons.

SEC - CFTC Accord

In December 1981, the Commission and the Commodity Futures Trading Commission reached an Accord clarifying their respective jurisdictions over trading in certain new options, futures, and options on futures products. With the substantial aid of the Committee on Banking, Housing, and Urban Affairs, the amendments to the federal securities and commodities laws called for by the Accord were passed by Congress and signed by President Reagan on October 13, 1982, and January 11, 1983, respectively. Enactment of the Accord enabled the Commission to authorize trading in Treasury, GNMA, foreign currency, certificates of deposit and stock index options. These new options will facilitate government and mortgage financing, international trade and institutional portfolio management by permitting the users of these products to hedge the risks of fluctuating interest rates, exchange rates and stock prices.

One question that has been raised both by members of Congress and by the securities industry is whether these new options and futures products are being brought on too quickly for the industry to absorb.

New Options Products

The Commission is aware of these concerns, and in examining new options product proposals from the securities exchanges, the Commission has thoroughly considered both the usefulness of the new products and the efforts expended by the exchanges to prepare the industry and the public for those products.

In its consideration of each of the options proposals approved to date, the Commission staff worked with the securities exchanges to ensure that trading of the products proceeded only after member firms and their account executives were fully educated about the product. In this regard, the Commission has adopted a practice of conditioning its orders approving new options products on the satisfaction of requirements designed to ensure the exchanges and industry were prepared for them. In each instance, prior to the start-up of trading, the securities exchanges have conducted seminars and training sessions for account executives, floor traders, back office personnel and clearing firms. Persons selling, or supervising the sale of, debt or foreign currency options are required to pass qualifying exams, and several thousand have done so. In addition, the Commission has demanded, and received, assurances from the securities exchanges that both the exchanges and their member firms were operationally ready to handle each new product. As a result of these efforts, trading has begun in each new product in an orderly fashion.

The Commission has also ensured that sufficient information regarding these new products is available to investors. The Commission has required the development of supplemental disclosure documents which discuss the mechanics, risks and uses of each new option product. The securities exchanges have adopted procedures to ensure that these disclosure documents were provided to investors before their accounts are approved for trading any new option product.

The securities exchanges also have moved cautiously in implementing their new products programs. To date, trading has commenced in Treasury bond, bill and note options and foreign currency options on the British Pound, Japanese Yen, Swiss Franc and German Mark. Trading volume has been relatively low, averaging between 200 and 600 contracts a day for the various products. Only one of the three exchanges approved to trade stock index options has commenced trading. The exchanges have not yet begun trading of other products such as options on GNMA's or certificates of deposit, but rather are concentrating on further developing the products that have begun trading.

New Futures Products

Under the terms of the Accord legislation, the Commission also has a consulting role with respect to stock index futures, as well as options on those futures, filed prior to December 9, 1982 and direct review, amounting to a veto power, of authority over any proposals filed after that date. Specifically, the Commission must consider (a) whether trading in the proposed futures contract is readily susceptible to manipulation, or to causing or being used in the manipulation in the price of any underlying security, an option on such security or an option on a group or index including such securities, and (b) whether the group of securities underlying the futures contract is a widely-published measure that reflects the market for a substantial segment of or all publicly-traded equity or debt securities and reflects that market, or is comparable to such measure. The Commission has sent a number of comment letters to the CFTC on the various stock index proposals after examining these proposals in light of the Accord and intends to continue to work with the CFTC both in the review of these proposals and in studying the effects of these products on the underlying securities markets. The Commission takes the review authority which Congress has provided it for stock index proposals very seriously and will carefully review all proposals to ensure that they meet the standards of the Accord.

While the consultation procedures provided for in the Accord generally have worked smoothly, a question has arisen concerning one aspect of the jurisdictional allocation of products between the two agencies. The Accord provides that the CFTC can approve the trading of options on futures on a board of trade. Since the CFTC is permitted to authorize futures on exempt securities and broad-based indexes, both instruments on which the Commission can authorize options trading, it is possible to have both options regulated by the Commission and options on futures regulated by the CFTC on these particular underlying instruments. This result was fully contemplated by the Accord. The question has arisen, however, whether an option on a stock index futures contract settled in cash which provides for simultaneous expiration of the option and future is actually an option on the underlying index falling under the SEC's jurisdiction. Notwithstanding numerous functional and pricing similarities, there are clear structural distinctions between the two types of instruments, even if the option on a future is constructed in this manner. It is the SEC's view that the Accord legislation intended jurisdictional allocation to be based on such structural differences.

Tender Offers

In the past two years, there have been a number of billion-dollar partial tender offers that have renewed public interest in the regulation of such offers and have highlighted a number of issues concerning such regulation. The Commission has undertaken two principal initiatives in response to these tender offer developments.

First, the Commission, on December 15, 1982, adopted revised Rule 14d-8 under the Securities Exchange Act that requires a bidder making a partial tender offer to accept shares on a pro rata basis throughout the term of the offer. Prior to the effectiveness of the new rule, a bidder was only required to accept shares pro rata for the first ten days of an offer and for ten days following the announcement of an increase in consideration to be paid for the shares. The Commission was of the view that the minimum ten calendar day proration period denied security holders an adequate opportunity to make informed investment decisions and, with the resulting multiple proration pools, leads to security holder confusion and misunderstanding. The extension of the proration rights throughout the term of the offer is designed to assure security holders in a partial tender offer the protections provided by the twenty business day minimum offering period prescribed by Rule 14e-1 under the Securities Exchange Act, *i.e.* the time necessary to consider the merits of the offer and to obtain sufficient information upon which to base their investment decisions.

The second initiative undertaken by the Commission in response to current tender offer activity was the Commission's establishment of an advisory committee on tender offers, which held its first meeting on March 18. The committee includes persons who have participated in the various facets of the tender offer process and others eminently qualified to analyze current regulation and possible improvements. It will consider tender offer practices and regulations in terms of the best interests of all shareholders and propose regulatory and legislative improvements for the benefit of all shareholders. A copy of the letter from the twelve members of the Banking Committee, suggesting issues to be addressed by the Advisory Committee, was provided to the members. In order to comply with the request by members of the Banking Committee for recommendations by July 31, the Commission has suggested a target date of July 8 for the Advisory Committee to make its recommendations to the Commission.

Disclosure Operations - The Review Process

Disclosure Operations' mission is to provide investors with material information and to prevent fraud and misrepresentation in connection with the trading, voting, and offering of securities for public sale. The staff seeks to accomplish this mission by reviewing disclosure documents and, where necessary, issuing comments to filers citing deficiencies and requesting their correction. The goal of the review process is to ensure compliance with the disclosure requirements of the Securities Act and the Securities Exchange Act. Matters which cannot be resolved by the comment process are referred to the Division of Enforcement.

The Division of Corporation Finance currently handles its review work through 10 branches, under five Assistant Directors. In 1962, the Division received some 18,000 filings. In 1968 the figure was 38,000 and in 1979 it was 54,000. In 1982 it was 65,000. The professional review staff size was 146 in 1962, 150 in 1968, 155 in 1979 and 150 in 1982. With reductions in manpower and an increase in total filings, improved strategies have been adopted.

In 1979, Disclosure Operations was reorganized by consolidating the personnel of the prior fifteen operating branches into ten larger units and the reassignment of companies to the new branches on the basis of industry groups (industry centralization).

The reorganization was instituted in recognition of the fact that effective discharge of the Division's responsibilities had become increasingly difficult due to the growth in the number and complexity of filings and more sophisticated securities transactions. Moreover, staff time required for developing recommendations regarding new disclosure policies and the elimination of obsolete disclosure requirements placed additional burdens on the Division's limited resources. Concurrent with the reorganization was the regulatory acknowledgment that not all filings could or needed to be reviewed. The Division implemented the selective review system in fiscal 1981 in order to concentrate the Division's resources on those filings that most warrant full review.

Selective review was the most practical response to increased volume of filings and decreased staff resources and resulted in immediate benefits in terms of a reduction in the backlog of filings and easier access to the capital markets. However, several impediments to progress to the Division's overall goal of its plan of reorganization and selective review have arisen. Included among these goals are uniformity and excellence of the review process and more timely reviews of Securities Exchange Act reports which are the touchstones of the integrated system. These impediments include substantial increases in first-time Securities Act filings, high employee turnover, and hiring freezes.

Under the selective review system, the decision to fully review a Securities Act filing or Securities Exchange Act report made by a company already reporting to the Commission is presently determined by, among other things, the identification of 1) companies which because of certain financial characteristics may have problems; 2) areas of disclosure common to many companies or an industry grouping which result from new developments or trends; 3) companies subject to investigations; 4) companies delinquent in their Securities Exchange Act reporting obligations; 5) companies with recent material defaults; 6) the initial annual report filed by first-time Securities Act filers; and 7) filings with unusual public interest including novel securities or business transactions.

A principal element of the selective review system is to divide filings into two groups - those which must be fully reviewed and those for which compliance can be reasonably assured by means of selective review. Sampling techniques have been developed and are continuing to be refined to aid in the screening process for incoming filings. A substantial aid to the screening process is the use of automated data and computer processing systems.

Under the screening procedures adopted by the Division it is intended that all first-time issuers continue to receive a full review. However, repeat offerings by reporting companies are reviewed on a selective basis. As a result, certain Securities Act registration statements are not reviewed. Instead, they become effective with the participants in the offering alerted to the fact that the Division has not made a review. Companies are notified promptly after filing whether their registration statements will be reviewed. In addition, in many cases companies no longer have to wait for staff comments before mailing proxy statements to shareholders. Such statements are filed with the Commission in preliminary form ten days before delivery to shareholders. If companies are not alerted within that period that the staff will have comments on the proxy statement, they will be free to mail copies. Similarly, selective review and "audit mode" procedures have been adopted with regard to periodic disclosure documents, such as the Form 10-K annual report, in order to provide closer scrutiny of those filings most likely to be in need of review.

Consistent with the provisions of the selective review system all filings received by the Division in 1982 were screened to determine the necessity for a full review. The selective review process is designed to use staff resources in the most cost-effective mannner. Given the historic highs in annual volumes of filings, however, not all filings identified for full reviews can be so reviewed in a timely manner.

Significant accomplishments were achieved in 1982 (often through the use of donated time by a conscientious staff -- some 9500 man hours). 85% of first-time Securities Act registration statements and 14.7% of annual reports on Form 10-K were fully reviewed. In this regard it is interesting to note that during the fiscal year ended September 30, 1980 there were 583 first-time Securities Act filers whereas in 1982 there were 1068. This represents an increase in such filings of almost 90% over the two-year period.

The review process produced substantial results. Fourteen filers were notified that their disclosures were so deficient that the staff could not review them; thus $189 million worth of securities were not publicly offered. A large number of material deficiencies were corrected through the comment process. This process generated 765 amendments to Securities Act filings that proposed almost $28 billion in securities for public sale. The process also generated 91 amendments to tender offers made under the Securities Exchange Act, with a total proposed offering price of almost $7 billion and produced 41 amendments to proxy contest filings involving assets exceeding $37 billion. Approximately 200 matters not resolved by the comment process were referred to the Enforcement Program, many of which resulted in vigorous action brought by the Commission for the protection of investors.

Integration

On February 24, 1982, the Commission announced the adoption of the final phase of its program to integrate the transaction-oriented disclosure system of the Securities Act with the continuous disclosure system of the Securities Exchange Act. Culminating several years' efforts, the final phase of the integrated disclosure system comprehensively revised, simplified and improved the disclosure requirements under both Acts, resulting in reduced compliance costs consistent with investor protection.

The final phase included: (1) three new registration forms -- Forms S-1, S-2, and S-3 -- which constitute the basic framework for registration under the Securities Act; (2) an expanded and reorganized Regulation S-K, which sets forth uniform disclosure standards under both Acts; (3) revised procedural requirements for the registration of securities under the Securities Act and the reports of certain issuers under the Exchange Act; (4) Rule 415 which governs the registration of securities on a delayed or continuous basis; (5) new Rule 176 identifying certain circumstances which may bear upon the determination of what constitutes reasonable investigation and reasonable ground for belief under Section 11(b) of the Securities Act; (6) a new rule and a statement of policy pertaining to the voluntary disclosure of securities ratings; (7) revisions to various rules, forms and schedules under both Acts to implement coordinating changes; and (8) the rescission of obsolete forms under both Acts and rescission of 88% of the Guides for the Preparation and Filing of Registration Statements and Reports.

Of note in the integration program was the adoption, on a temporary basis of Rule 415, governing the registration of securities to be sold on a delayed or continuous basis. In adopting the rule, the Commission noted that it had been the subject of substantial commentary, varying from support for the rule, as proposed or with modifications, to concern that the proposal would have adverse effects on the capital raising process and the securities trading markets. Recognizing the commentators' concerns, the Commission conducted five days of public hearings to afford an additional opportunity for continued consideration of the shelf registration process. In September 1982, the Commission determined that additional experience was necessary in order to assess fully the issues raised, and therefore extended the effective period for the rule until December 31, 1983.

On November 19, 1982, the Commission adopted the foreign issuer integrated disclosure system. Forms F-1, F-2 and F-3 were adopted to provide an integrated disclosure system for non-North American foreign private issuers similar to that adopted for North American issuers. Form F-3, which is available to "world class" issuers that have been filing periodic reports under the Securities Exchange Act for at least three years, relies on incorporation by reference of such periodic reports. Form F-2, which is available to other world class issuers and to any non-North American foreign private issuer that has been filing periodic reports for at least three years, requires delivering such reports to investors with the prospectus. Form F-1, which is available to any non-North American foreign private issuer, requires information to be included in the prospectus. Concurrently, rules relating to the age of financial statements and the currency in which financial statements could be presented were adopted.

One of the goals of these actions was to reduce burdens on registrants while, at the same time, ensuring that investors are provided with meaningful information on which to base investment decisions. It is estimated that integration will save corporations (and, therefore, their shareholders) $350 million per annum, without compromising full disclosure to investors. This estimate reflects anticipated cost savings from: (1) new registration Forms S-1, S-2 and S-3, with expanded eligibility for short forms and streamlined procedures and disclosure requirements; (2) reduction in the cost associated with Commission processing of the above documents; (3) amendments to Form S-8 for the registration of employee benefit plans, which streamlined disclosure requirements and provided for automatic updating through incorporation by reference;

(4) new Form S-15, a simplified form for certain types of business combinations, which utilizes existing annual reports and therefore is much less expensive to prepare than other available forms; (5) reduction in reporting burdens for various other forms as a result of the streamlining of disclosure requirements; (6) the availability of short registration forms for foreign issuers; (7) new Rule 415, which eliminates the necessity of filing separate registration statements for multiple offerings and permits issuers to go to market quickly according to financing needs and market conditions; and (8) reduction in underwriting spreads since Rule 415 has been in effect.

Proxy Review Program

During 1982, the Commission initiated a major program to review the disclosure and procedural rules governing the proxy solicitation process. The proxy review program consists of six components: (1) revision of the rules relating to the disclosure of certain relationships and transactions with management -- new Item 404 of Regulation S-K; (2) revision of the rules governing the disclosure of management remuneration -- Item 402 of Regulation S-K; (3) reexamination of Rule 14a-8 under the Securities Exchange Act regarding shareholder proposals; (4) simplification of Form S-14 for merger proxy statements; (5) review of the rules concerning proxy contests; and (6) evaluation of the recommendations of the

Advisory Committee on Shareholder Communications concerning the process by which issuers communicate with the beneficial owners of nominee held securities.

As a first step, on July 9, 1982, the Commission proposed for public comment a new Item 404 of Regulation S-K, "Certain Relationships and Related Transactions," which governs the disclosure of management relationships and transactions in proxy statements, registration statements and periodic reports. After considering the comments received, on December 2, 1982, the Commission adopted new Item 404, with minor modifications. New Item 404 integrates two disclosure provisions: former Item 402(f) of Regulation S-K, relating to the disclosure of transactions in which directors, officers, director nominees and certain of their associates have a material interest; and former Item 6(b) of Schedule 14A relating to relationships between directors, officers, nominees, certain owners and significant customers, suppliers and creditors.

On October 14, 1982, the Commission issued a release soliciting public comment on a wide variety of issues relating to the shareholder proposal process and on three alternative proposals for dealing with those issues: (1) proposal I would retain the framework of current Securities Exchange Act Rule 14a-8, with certain changes designed to clarify the rule and simplify its application; (2) proposal II would permit the issuer, with shareholders' approval, to vary the procedures set forth in the rule; and (3) proposal III would require inclusion in the issuer's proxy statement of all shareholder proposals proper under state law and not involving an election of directors, subject to a numerical limitation. The comment period for these proposals ended on February 24, 1983.

On December 2, 1982, the Commission published for comment proposed rule amendments which reflect certain of the recommendations made by the Advisory Committee on Shareholder Communications in its report delivered to the Division of Corporation Finance in June 1982. The proposed amendments would: (1) tighten the timetable for proxy distribution; (2) under certain limited circumstances, eliminate the obligation of an issuer to disseminate the material that must be delivered to beneficial owners pursuant to current rules; and (3) establish, without altering the current process for proxy distribution, a means by which issuers could obtain the identities, addresses and security positions of consenting beneficial owners. The comment period for these proposals ended on March 11, 1983.

Most recently, on January 17, 1983, the Commission published for comment proposed amendments to Item 402 of Regulation S-K, governing the disclosure of management remuneration. The proposed amendments are intended to simplify disclosure and reduce compliance burdens in a manner consistent with investor protection. The proposed revisions reflect three primary themes: (1) the proposed item focuses on remuneration actually received or vested; disclosure of contingent remuneration is proposed to be eliminated; (2) the proposed remuneration table would include cash paid to the named individuals and group during the last fiscal year; other remuneration could be presented in a narrative, tabular or other format, at the option of the registrant; and (3) the proposed item focuses on those persons who perform policy making functions for the registrant by limiting group disclosure to directors and executive officers.

Proposed Item 402 is divided into five sections: disclosure, in a tabular format, of cash amounts paid or earned during the last fiscal year; disclosure of remuneration paid or to be paid pursuant to various plans, which would be made in connection with the description of such plans and, for the most part, would allow registrants discretion to choose the appropriate format; disclosure of other remuneration not otherwise covered, such as perquisites, unless the aggregate of such other remuneration does not exceed the greater of $10,000 or 10 percent of the cash remuneration disclosed in the Cash Remuneration Table; disclosure of standard and other arrangements for the compensation of directors; and disclosure of remuneration plans or arrangements relating to termination of employment. The comment period for the proposed revisions to Item 402 ends May 1, 1983.

Finally, in the past month, the Commission has begun work on two other components of the Proxy Review Program -- simplification of the Form S-14 merger proxy statement and review of the rules governing proxy contests.

Research Forum

To improve communication between the Commission and various users of the Commission's disclosure documents, the Commission initiated the first Research Forum, held on November 17, 1982. Over 40 representatives from various types of users of Commission documents, such as securities analysts, institutional investors, investment advisers, rating organizations and shareholder groups, were invited to meet with the Commission and staff for discussion of issues relating to the form and content of disclosure documents, including: (1) non-financial reporting requirements; (2) financial reporting requirements; and (3) proxy statement disclosure requirements.

Of particular importance, the Commission solicited views on how Commission releases could be improved and how users of disclosure documents could be encouraged to be more responsive to the Commission's requests for comments on proposed rulemaking initiatives.

Small Business Activities

1. Regulation D

In March 1982, the Commission adopted Regulation D, a series of rules providing exemptions from the Securities Act registration provisions for certain limited offerings of securities. The regulation simplifies the rules relating to limited and private offerings, eliminates unnecessary restrictions, facilitates capital formation in a manner consistent with investor protection, and should reduce costs to small businesses by an estimated $50 million per year. 21/ The regulation also groups together conditions for the use of the limited offering exemptions and definitions which the exemptions have in common and adds certainty to the exemptions by defining with objective standards the term "accredited investor" which generally pertains to institutional investors, such as banks and certain employee benefit plans, as well as individuals, partnerships, and corporations that satisfy specified financial requirements.

The Commission has continued to coordinate with the North American Securities Administrators Association ("NASAA"), through its Subcommittee on Small Business Financing, to develop a basic framework of limited offering exemptions that can apply uniformly at the federal and state levels, pursuant to Section 19(c)(3) of the Securities Act added by the Small Business Investment Incentive Act of 1980. The

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21/ This $50 million figure is derived by estimating that one-half of the issuers using Rule 505 of Regulation D at an average offering price of $2.5 million would otherwise incur the cost of an additional 2% of the aggregate offering price involved in filing a registration statement.

Commission coordinated with NASAA during the proposal and adoption of Regulation D. State securities administrators currently are individually considering adoption of a uniform exemptive scheme based on Regulation D or a variation endorsed by NASAA. The Commission and NASAA believe that their coordinated efforts will result in a significant reduction of the burdens on small businesses by eliminating some of the differences between federal and state securities regulation.

2. Government-Business Forum on Capital Formation

Congress, in the Small Business Investment Incentive Act of 1980, directed the Commission to conduct an annual Government-Business Forum "to review the current status of problems and programs relating to small business capital formation," and to include as participants other Federal agencies, state securities commissioners and leading small business and professional organizations concerned with capital formation. The first Forum was held on September 23-25, 1982, and was attended by approximately 175 small business executives, accountants, attorneys, financial analysts, economists, broker-dealers, venture capital investors, financial advisers, bankers and government officials. The participants approved 37 legislative and regulatory recommendations in the areas of access to financial institutions, securities, tax and credit. On December 1, 1982, the Final Report of the Forum was presented to Congress in a joint hearing of members of the House and Senate Small Business Committees. It is anticipated that a number of the legislative recommendations may be incorporated into proposed legislation during the new Congress and that many of the regulatory recommendations will be given serious consideration by the affected agencies, including the Commission.

3. Classification of Issuers

In April 1982, the Commission established a system of classifying small issuers for purposes of exempting certain of them from reporting and other obligations under the Securities Exchange Act. The system provides a rational adjustment to the criteria for entry into, or exit from, the Securities Exchange Act reporting system and eliminates the costs of complying with the registration and reporting provisions of the Securities Exchange Act for the smallest issuers.

The new classification system changed the reporting scheme in a number of ways. A company not listed on a national securities exchange will not have to register under the Securities Exchange Act until it has 500 or more record holders of a class of equity securities and total assets of $3 million or more. This represents an inflation adjustment of the former $1 million total asset requirement which was established in 1964. In addition, a company that is subject to the reporting requirements of the Securities Exchange Act generally may end its reporting obligations if it has fewer than 500 record holders of the class and the company has had total assets of less than $3 million at the end of its last three fiscal years.

4. Form S-18

The Commission also broadened the availability of Form S-18, the simplified Securities Act registration form for issuers going public for the first time. Since its introduction in 1979, this form, which is filed with the Commission's regional offices, has substantially displaced Form S-1, the standard long form registration statement, as the registration form for public offerings up to $5 million. The recent revisions to the form now allow non-corporate issuers, such as limited partnerships (including real estate limited partnerships) and issuers engaged in oil and gas operations, to utilize the form.

Corporate Reorganizations

Reorganization proceedings in the United States Courts are commenced by a debtor or by its creditors. Federal bankruptcy law allows a debtor in reorganization to continue to operate under the court's protection while it attempts to rehabilitate its business and work out a plan to pay its debts. Where a debtor corporation has publicly held securities outstanding, such cases raise many issues that materially affect the rights of public investors. The issuance of new securities to creditors and shareholders pursuant to a plan are exempt from registration under the Securities Act. The Commission enters its appearance and participates in corporate reorganization proceedings to protect the interests of public investors holding the debtor's securities and to render independent, expert assistance to the courts and parties in a complex area of law and finance.

Chapter 11 of the Bankruptcy Code authorizes the Commission to enter its appearance in any reorganization case and to raise, or present its views on, any issue in a Chapter 11 case. Although Chapter 11 applies to all types of business reorganizations, the Commission, in its 40 years of participation in reorganization cases, has generally limited its participation to those in which a substantial public investor interest was involved.

During fiscal 1982, 76 debtors with publicly issued securities outstanding entered Chapter 11 reorganization proceedings. The Commission entered its appearance in 28 of these cases, with aggregate assets of $8.8 billion and close to 290,000 public investors, compared to 18 cases with $2.5 billion and 130,000 investors in 1981.

The Commission has been concerned to insure that public investors are adequately represented in Chapter 11 cases, especially since a plan of reorganization is developed through negotiations between the debtor and committees. During the fiscal year, the Commission moved or supported the appointment of investor committees in eight Chapter 11 cases involving about 70,000 investors. Committees were appointed in all cases except one which commenced a liquidation of its assets. In two of these cases, plans filed by the debtor in possession, after negotiations with the committees, accorded public investors a significant interest in the reorganized company.

The Commission has also moved for the appointment of a trustee in one case and an examiner in three cases. In two cases the examiner's preliminary report indicated a high probability of the existence of causes of action against former officers, directors and, possibly, accountants. In two other cases, examiners, appointed in the previous year, have filed reports recommending (1) the pursuit of causes against former officers, counsel, and others and (2) subordination of certain senior bank creditor claims, respectively.

During the past year, the Commission has reviewed applications for interim allowances filed by professionals in all participating Chapter 11 cases. As a result of the Commission's efforts, courts have adhered to the long-standing policy of paying only a portion of interim allowances, generally limiting the award to about 75% of the request.

Accounting Matters

1. Summary

During the last fiscal year, the Commission's efforts in the accounting area have been to encourage and continue to oversee the accounting profession's self-regulatory efforts and the private sector's accounting and auditing standard-setting processes, to eliminate accounting-related rules and interpretations that no longer contribute to the usefulness of financial reporting and simplify many of the remaining requirements, and to consolidate in one publication a codification of those sections of Commission releases that deal with accounting issues and provide current and meaningful guidance for persons complying with the federal securities laws. In addition, the staff's Office of the Chief Accountant has publicized its views on various important accounting issues.

2. Oversight of the Accounting Profession

The objective of the Commission's oversight is to assure that the private sector is improving the usefulness, integrity and credibility of financial reporting by public entities. The Commission has historically monitored, relied on and encouraged initiatives in the standard-setting processes of the private sector, subject to Commission oversight. Notwithstanding its limited resources, the Commission has an effective and efficient impact on standard-setting through frequent staff contact with the private sector standard-setting organizations, attendance at or participation in meetings, public hearings, and task forces, and review and comment during the standard-setting process.

The Commission has the statutory responsibility to be satisfied with the accounting principles underlying financial information, the auditing standards by which it is reviewed, and the independence and competency of the profession which performs that review. Although the Commission will continue to seek to fulfill its responsibility by close oversight of private sector initiatives, it will not hesitate to take appropriate regulatory action when necessary.

3. SEC Practice Section and Peer Review

The accounting profession's newest self-regulatory organization -- the Division for CPA Firms of the American Institute of Certified Public Accountants and, particularly, its SEC Practice Section ("SECPS") -- has made progress toward its objective of improving the quality of practice by accounting firms that audit the financial statements of companies which file registration statements and reports with the Commission. As of June 30, 1982, 428 accounting firms had voluntarily become members of the SECPS; these firms audit over 90% of all publicly held companies. Members of the SECPS are subject to certain requirements designed to improve the quality of their audit and accounting practice. Among these are the filing of an annual report, the maintenance of a system of quality control, and the testing of that system once every three years through an independent peer review process. An independent Public Oversight Board ("POB") oversees and annually reports on the SECPS.

Based on the review by the Commission's staff of a sample of the working papers underlying peer reviews and of the POB's oversight files, the Commission has determined that it can rely to a great extent on the POB's oversight function in fulfilling its own oversight responsibilities. Nevertheless, the Commission will continue to monitor the peer review process by reviewing certain working papers so that it can periodically evaluate this important self-regulatory initiative and the need for refinements in the process as a result of changing professional, economic and regulatory conditions.

The true test of any voluntary self-regulatory organization is whether it appropriately sanctions members that do not meet its standards. The Commission thus far has no basis for reaching any conclusion as to that aspect of the SECPS's disciplinary procedures which involves the evaluation of allegations against member firms of deficiencies in the conduct of an audit or in reporting thereon in connection with any required filing under the Federal securities laws to determine the need for corrective measures by such firms, changes in professional standards, or appropriate disciplinary measures. Visible evidence as to specific SECPS activity is critical, however, to demonstrate to the public the effectiveness of this aspect of the profession's self-regulation.

4. FASB Activities

The Commission's staff monitors the activities of the Financial Accounting Standards Board (FASB), the private sector accounting standard setting body. Some of the areas the FASB has worked on or is working on now include the development of a conceptual framework of accounting, foreign currency translation, consolidations and the equity method of accounting, accounting for income taxes and pensions, and disclosures about oil and gas producing companies.

5. Other Significant Financial Reporting Issues

During the past year, the Commission continued to be involved with several important financial reporting issues including: (a) oil and gas disclosures; and (b) reporting on internal accounting control; and (c) various international standard-setting activities. A brief discussion of these issues follows.

(a) Financial Reporting Practices for Oil and Gas Producers

During the fiscal year, the Commission and its staff continued to be involved in the development of a package of supplemental disclosures by oil and gas producing companies. The Commission's requirements called for companies to disclose supplementary information about the value of their reserves, changes in those values and an alternative measure of performance, all based on the reserve recognition method of accounting ("RRA"). RRA disclosures were implemented in 1979 as a Commission experiment to develop a new method of accounting which would adequately reflect in financial statements the significance of proved oil and gas reserves. In February 1981, the Commission concluded that RRA did not currently possess the requisite degree of certainty for use as a primary method of accounting, and expressed its support for an FASB project to develop a comprehensive set of disclosures for oil and gas producers. In November 1982, the FASB published a final statement calling for supplemental oil and gas disclosures. Since the Commission believes that the statement calls for adequate information about oil and gas producing activities, it amended its rules in December 1982 to require disclosure of the information specified in the FASB statement.

(b) Management Reports -- In January 1982, the Commission announced that it was no longer considering further action to require disclosure of a statement of management on internal accounting control in annual reports to security holders or filings with the Commission. In reaching this conclusion, the Commission considered the significant private sector initiatives in this area, including the increased number of voluntary management reports included in the annual reports to security holders of large companies. Although the Commission now believes that there is no need for a regulatory requirement for disclosures in this area, it continues to stress the importance to companies of effective systems of internal accounting control.

(c) International Accounting and Reporting

The growth of multinational enterprises and the increasing internationalization of the world's capital markets emphasizes the need for a greater degree of uniformity in informational requirements to improve comparability and make disclosures more useful and understandable.

A number of regional and international bodies are working to narrow the differences between financial reporting standards and otherwise increase comparability in this area. These include: (a) the United Nations ("UN") which, through a group of experts on international standards of accounting and reporting, is attempting to develop a comprehensive list of minimum disclosures of financial and non-financial information in general purpose reports; (b) the Organization for Economic Cooperation and Development ("OECD") which has published guidelines for multinational enterprises including a disclosure chapter and is developing guidance and elaboration on disclosure items and attempting to encourage the harmonization of international accounting and reporting standards; and (c) the International Accounting Standards Committee which issues accounting standards for consideration by its member countries and others. A related organization, the International Federation of Accountants, issues auditing standards. The United States is a participant in all the above activities either through government or professional organizations.

The Office of the Chief Accountant monitors developments in international accounting and reporting, maintains communications with various national and international bodies and reviews and sometimes comments on their proposals. The United States is represented in the UN and OECD by the Department of State in consultation with interested government agencies. For the past several years, the Commission has furnished a staff member from its Office of the Chief Accountant to serve as an expert advisor on the United States delegation to the UN and OECD working groups. While the Commission recognizes that the harmonization process is a long term project, it is hoped that these efforts will continue since they can increase the efficiency of the world's capital markets.

6. Accounting-Related Rules and Interpretations

The Commission's accounting-related rules and interpretations serve primarily to supplement generally accepted accounting principles ("GAAP"), as established by the private sector, by addressing those areas which are unique to Commission filings or where GAAP is not explicit. The Commission continually evaluates its requirements as the private sector changes financial reporting standards, and modifies or eliminates those requirements which become unnecessary.

The Commission's principal accounting requirements are embodied in Regulation S-X which governs the form and content of, and requirements for, financial statements filed under the Federal securities laws. The Commission also publicizes its views on various accounting and financial reporting matters in Financial Reporting Releases ("FRRs"). For example, in August 1982, the Commission announced that, while the FASB considered a final standard, financial reporting should be consistent with the tentative conclusions of the FASB concerning the proper accounting treatment for transactions intended to have the same substantive effect as a legal extinguishment of debt, even though the debtor's obligations are not in fact discharged as a legal matter.

In addition, the Commission's staff periodically issues Staff Accounting Bulletins ("SABs") as a means of informing the financial community of its views on accounting and disclosure issues. For example, during the past year, the staff published SABs on various financial reporting topics including: (a) application of the purchase accounting method to business combinations involving financial institutions; (b) implementation of the Commission's revised requirements for separate parent company only financial information; (c) presentation of certain pro forma information in connection with business combinations; (d) updated interpretations of interim financial reporting requirements; (e) preparation of financial statements of oil and gas exchange offers and application of the Commission's rules for oil and gas producing activities; and (f) valuation of certain assets acquired from related parties.

7. SABs 49 and 49A

The Commission's staff has recently issued two Staff Accounting Bulletins to ensure that bank holding companies adequately disclose information about loans to foreign countries that are experiencing liquidity problems. The first, Staff Accounting Bulletin No. 49, isued on October 26, 1982, generally calls for disclosure by bank holding companies about loans to public- and private-sector borrowers located in countries that are experiencing liquidity problems when aggregate outstandings (i.e., loans, acceptances, deposits, etc.) to that country exceed one percent of the registrant's total outstandings. The objective of the SAB is to elicit disclosures about material exposures in foreign countries in which the current political or economic conditions may cause borrowers to have difficulty in obtaining the necessary currency to make timely interest or principal payments.

Staff Accounting Bulletin No. 49A, issued on January 18, 1983, sets forth the staff's views regarding the need for additional disclosures about material subsequent developments regarding outstandings to foreign countries experiencing liquidity problems. The SAB calls for disclosure about negotiations or agreements entered into with foreign countries and others regarding the restructuring of debt, the availability of new borrowings and related matters. The SAB also emphasizes that it is the registrant's responsibility to carefully analyze the complex considerations related to such arrangements to determine whether the loans should be classified as "non-performing" in Commission filings.

The Commission has instructed the staff to monitor closely the accounting and disclosure practices in this area to ensure that appropriate information is being provided to investors.

8. Sunset Review

During the past year, the Commission has continued to devote substantial resources to a comprehensive review of its existing accounting-related rules and interpretations. The objective of this review is to ensure that the Commission's requirements remain necessary and cost-effective in today's environment and that they contribute to the usefulness of financial reporting. As a result of this effort, the Commission has made progress in reducing and simplifying its rules without sacrificing the integrity of financial disclosure documents. Some specific initiatives in this area are discussed below.

(a) Codification of Financial Reporting Policies

In April 1982, the Commission issued FRR No. 1 which announced the publication of a codification of certain existing Accounting Series Releases ("ASRs"). Of the 207 ASRs dealing with general accounting issues, 57 had been rescinded earlier and 79 were no longer relevant. Portions of the remaining

ASRs were codified because they contained current and meaningful guidance for persons complying with the Commission requirements. The codification is indexed and organized in a logical manner and should provide a useful reference for the Commission's current published views on accounting and auditing matters relating to financial reporting. It will be updated by future FRRs where appropriate.

In a related action, the Commission published Accounting and Auditing Enforcement Release ("AAER") No. 1 as the first in a new series of releases which will be used to announce accounting and auditing matters that are related to Commission enforcement activities. AAER No. 1 includes a topical index for the material included in the 100 enforcement-related ASRs to facilitate reference to specific areas addressed by the Commission in those releases.

(b) Regulation S-X

As part of the continuing effort to update and streamline the Commission's regulations, the Commission has: (1) adopted uniform instructions for the presentation of pro forma financial information; (2) revised the requirements for filing financial statements of businesses acquired or to be acquired; (3) simplified and standardized the requirements for disclosure of a ratio of earnings to fixed charges; (4) revised the financial statement and industry guide requirements for bank holding companies; and (5) revised the financial statement requirements for investment companies. With the Commission's adoption on March 7, 1983 of the proposed rules regarding financial statement requirements for bank holding companies, the Commission has substantially completed a project initiated in 1980. That project was intended to establish uniform requirements applicable to virtually all filings with the Commission pursuant to the Securities Act and the Securities Exchange Act as well as to annual reports to security holders prepared in accordance with the Commission's proxy rules.

(c) Scope of Services by Independent Accountants

In January 1982, the Commission announced the rescission of the rule requiring disclosure in proxy statements about nonaudit services performed by independent accountants for their audit clients. That rule, adopted in 1978, was intended to facilitate a better understanding by investors of the relationships between registrants and independent accountants at a time when some people were concerned that the performance of nonaudit services might impair accountants' independence. The Commission rescinded that rule in ASR No. 304 (January 28, 1982) because it concluded that, although information about nonaudit services is important to enable the Commission and others to monitor this activity by accountants, it is not generally of sufficient utility to investors to justify continuation of the disclosure requirement. In addition, the

Commission noted that information about nonaudit services performed by accountants will continue to be available to interested persons because the SECPS revised its membership provisions to require member firms to disclose additional information about their nonaudit sevice activity in public annual reports filed with the SECPS.

In ASR No. 304, the Commission also responded to criticism of its withdrawal of ASR No. 264 (June 14, 1979) which discussed the evaluation of the impact of the performance of nonaudit services on auditor independence. It rejected the suggestions that it reinstate or repeat the substance of ASR No. 264, and stated that its views on accountants' independence were clearly articulated in ASR No. 296 (August 20, 1981) and that registrants and accountants understand and appreciate that accountants' independence must be carefully evaluated and preserved. The Commission also observed that it was satisfied that the self-regulatory mechanism established by the accounting profession, accountants, audit committees and managements should ensure that adequate consideration is given to the impact of nonaudit services on accountants' independence.

The Commission concluded ASR No. 304 with the warning that it would take further action if either the fact or apperarance of accountants' independence is questioned in the future.

National Market System

On June 11, 1980, the Commission adopted Rule 19c-3 which permitted exchange member firms to make markets off-board in direct competition with exchange specialists in securities listed on an exchange after April 26, 1979. At the time Rule 19c-3 was adopted, the Commission recognized that effective competition for order flow would be impaired unless an efficient linkage between exchange and off-board markets was developed. Accordingly, on April 21, 1981, the Commission ordered an automated interface between the Computer Assisted Execution System operated by the NASD and the Intermarket Trading System operated by seven national securities exchanges. The interface became operational on May 17, 1982 and is being carefully monitored by the Commission and the securities industry. Commission monitoring, to date, indicates that price continuity in transactions in linked stocks has improved slightly since the advent of the interface.

In connection with Rule 19c-3 and the linkage, the Commission proposed an order exposure rule applicable to both off-board and exchange market makers, and based on principles developed by a Securities Industry Association Committee, which addressed the concerns of certain segments of the securities industry over broker-dealers internalizing execution of their retail customer orders. The Commission expects to take action in the order exposure area by June 1983.

Net Capital Rule

The securities industry's net capital, clearing house deposit and stock loan collateral requirements were updated to take into account the industry's improved financial and operational condition. Larger discounts were imposed on the industry's bond holdings for net capital purposes in response to the greater volatility of these markets. However, the net result was that over $500 million of securities industry capital was freed-up for more efficient employment. Such capital has helped the industry handle the much greater breadth and depth of the securities markets since August and improve other services to investors.

Intermarket Surveillance and MOSS

The Exchanges and the NASD have made significant progress in developing an intermarket surveillance program. This progress includes: (i) identification and definition of intermarket violations; (ii) development of basic procedures to detect these violations; (iii) on-site review of the procedures and programs of each self-regulatory organization ("SRO") to detect these violations; (iv) development of a system to collect and disseminate intermarket trading information needed for the detection of the violations; and (v) procedures to allocate responsibility for the detection and investigation of the intermarket violations. The Commission staff has monitored this activity through regular written reports submitted by the SROs and by attending meetings of the Intermarket Surveillance Group ("ISG"). While the ISG has been responsive in providing information to the Commission, and has proceeded generally in line with its proposed time schedule, some difficulties in collecting and organizing trading data in a useful format have required unplanned modification of the initial ISG plan. The Commission staff continues to monitor ISG progress and expects that an effective and functioning intermarket surveillance program will be in place by the end of this year.

In light of the progress of the SROs, including New York Stock Exchange ("NYSE") implementation of audit trail capability, the Commission has redirected its own Market Oversight Surveillance System Program ("MOSS"). Instead of building the originally proposed system which included a direct surveillance capability, the Commission has directed its efforts to using the facilities and expertise gained in the MOSS experience to develop a much more limited system. This will give the Commission an effective audit capability to oversee the primary market surveillance activities of the SROs, and will provide necessary trading data to support the Commission's investigative and regulatory programs. Since the beginning of the fiscal year, the Commission has increased the surveillance capacity of MOSS to include all listed equity securities and options.

The Commission's next formal status report to Congress on MOSS, the ISG and the NYSE audit trail will be delivered April 1, 1983.

Unitary Investment Trusts

Some investment company industry observers recently have questioned the efficacy of shareholder voting and director requirements for mutual funds under the Investment Company Act. On December 10, 1982, the Commission published an advance concept release (Investment Company Act Release No. 12888), requesting public comment on whether the Commission should recommend legislation or propose rules to enable all or certain types of open-end investment companies to be organized and operated without shareholder voting, or without either shareholder voting or boards of directors.

The release and the appendix discuss in detail two alternative approaches to mutual fund governance which have been advocated by industry observers, emphasizing that the Commission has not taken any firm position on which approach would be preferable or whether, in fact, any change in mutual fund governance would be desirable. Although the Commission has requested comment on whether these approaches should be implemented administratively or legislatively, the release states that, in the preliminary judgment of the Commission, changes of this magnitude should be implemented legislatively.

According to some industry observers, an alternative approach to mutual fund governance should be developed in view of recent industry trends, particularly the emergence of money market funds and other no-load funds.

Wealthy individuals engage investment managers. If they are dissatisfied with the manager's performance, they withdraw their funds. The same privileges are available to open-end fund investors. The withdrawal of funds is a more effective management discipline than that afforded by proxy statements. Since investors in such funds may more readily redeem their shares, industry observers have suggested that mutual funds be given: (i) exemptions from shareholder voting requirements under the Investment Company Act; or (ii) the option of converting into internally managed unitary investment funds ("UIFs") without voting shareholders or boards of directors. These approaches to restructuring investment companies could of course be modified. For example, exemptions from shareholder voting or UIF legislation could be limited to money market funds, at least initially until the Commission and the industry gain more experience with a new regulatory framework. It should be noted that, under both approaches, most of the other regulatory requirements and prohibitions contained in the Act, including those relating to self-dealing, would be retained.

In evaluating the possibility of creating either a unitary investment fund or exemptions from the Investment Company Act's shareholder voting requirements, difficult questions are presented as to whether shareholders should lose their voice in fund management and, if so, whether conditions could be fashioned which would afford them adequate notice, ease of redeemability and some sort of referendum rights. Evaluation of the UIF concept also presents difficult questions as to whether the directors, and particularly the independent directors, should be eliminated from fund management in view of exemptive rules adopted by the Commission which rely on the judgment of the unaffiliated directors. If the directors were to be eliminated in a UIF context, conditions would have to be fashioned which would adequately mitigate potential conflicts of interest between the investment manager and fund shareholders.

Investment Company Self-Regulatory Organization

As the Subcommittee is aware, the investment company industry has experienced dramatic growth in recent years in terms of both net assets and the number of investment companies registered with the Commision. 22/ The Commission expects the number of registered companies to continue to increase, in part, because of greater competition among securities firms, insurance companies and banking institutions in offering new investment vehicles to the public. In order to minimize the impact of reduced staff levels, the Commission has implemented streamlined inspection procedures to increase the over-all efficiency of its examination program. Routine unannounced inspections of investment companies identify violations at a sufficiently early stage to minimize the risk of loss to investors. These examinations also have an important deterrent effect.

In light of projected continued growth in the industry the Commission is considering alternatives to ensure that investment company inspections will continue to be conducted with sufficient regularity in the future. One possibility is using private entities to supplement the Commission examination program.

The Commission has issued a concept release (Investment Company Act Release No. 13044, Feb. 23, 1983) requesting comment as to whether it is desirable or feasible to use private entities to assume partial responsibility for certain

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22/ During fiscal years 1981 and 1982 the number of registered investment companies increased by 368 to a total of 1830 which represents an annual growth rate of approximately 12%. This rate of growth of the number of registered investment companies has continued in the current fiscal year notwithstanding the decline in net assets of money market funds discussed below.

functions involving routine examinations of investment companies. The alternatives discussed in the release are (1) authorization of the creation of one or more SROs to conduct routine periodic examinations of investment companies; (2) the use of investment company independent auditors to conduct certain additional procedures as a substitute for some of the procedures now performed by Commission examiners during a routine examination; and (3) some combination of alternatives (1) and (2) above. The release makes it clear that any alternative would be a supplement to, and not a substitute for, the Commission's examination program and that provisions for adequate oversight by the Commission would be required in order to maintain the Commission presence necessary to ensure that this agency's investor protection responsibilities are being met. In this regard, we contemplate that under any of the alternatives, the Commission would continue to conduct certain examinations, including cause and oversight examinations. The use of private entities to conduct routine examinations would free our examiners to concentrate on those inspection areas that are more complex and pose greater risks to shareholders.

The Impact of the Money Market Deposit Account on the Assets of Money Market Funds

The assets of taxable money market funds have declined from $223 billion as of December 15, 1982 to $188 billion as of February 23, 1983, a decrease of about $35 billion since the introduction by financial institutions of the new Money Market Deposit Account ("MMDA") on December 14, 1982. (Money market funds investing in state and municipal securities have increased their net assets by about $2 billion during the same period). The high introductory rates and deposit insurance offered by these institutions on the MMDA have been responsible for some but not all of the decline. Current economic conditions and the recovery in the capital markets have also contributed to the outflow.

Over the past year, short-term interest rates generally have been declining. As the yields investors earn on money fund shares decline, such investments become less attractive in comparison to other securities particularly if the potential returns that can be earned on alternative investments are high. The relatively high current yields on long term municipal bonds and the surging equity markets, which seem to be again attracting individual investors, appear to be responsible for a portion of the recent decline in money fund assets.

The very aggressive advertising campaigns being conducted for MMDAs, which frequently offer above-market interest rates as inducements to open accounts, and the availability of federal insurance on these deposits have resulted in the growth of these accounts to an estimated $267 billion as of February 16, 1983. 23/ There are educated guesses that approximately $20 billion or 7-8% of these deposits came from the money funds. The bulk of the deposits, therefore, appear to

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23/ Federal Reserve Statistical Release No. H6(508) February 25, 1983.

have come from existing accounts at the financial institutions. 24/

It appears that money market funds have had no substantial problems in meeting shareholder redemption requests. This is due in large part to the high level of responsibility and prudence of money market fund managers and protective rules under the Investment Company Act, which include rigorous asset liquidity and asset valuation requirements.

Other Matters Undertaken by the Division of Investment Management

1. Inspections

As mentioned above, the Commission conducts inspections of registered investment companies and investment advisers to determine whether their investment and operational activities conform to disclosure in material filed with the Commission (such as, prospectuses and registration statements) and comply with the regulatory statutes that apply to such entities. The deterrent effect produced by these examinations is vital to the success of the investment management program. Registrants' knowledge that unannounced inspections might identify deficient activities that could lead to enforcement action serves to deter abuses by these entities and minimizes the risk of loss to investors.

24/ "S&Ls Draw Big Deposits in Unregulated Accounts," *Wall Street Journal*, January 5, 1983, p. 16.

During inspections, examiners obtain all relevant books and records, confirm portfolio securities with custodian banks, audit calculations of net asset values and fees, review shareholder purchase and redemption transactions and discuss investment and operational activities with management. Thereafter, an inspection report is prepared and based upon the report one of three actions follows: (1) no further action is taken; (2) a letter identifying deficient activities and requesting immediate corrective action is sent to the registrant; or (3) the report is referred to the fraud program for further consideration and investigation.

During fiscal year 1982, the Commission completed 1,065 investment company and investment adviser inspections. This was a record for the Commission, representing a 26% increase over the number of inspections completed in fiscal 1981. Most of the increase was attributable to an increase in the number of investment adviser inspections. 25/ The staff was able to improve its productivity in this area despite budgetary constraints and personnel reductions through the use of new computerized targeting and risk appraisal techniques. More specifically, the staff developed a computer program which:

25/ The number of completed inspections of investment advisers increased from 512 in fiscal 1981 to 710 in fiscal 1982 whereas the number of completed inspections of investment companies increased from 336 in fiscal 1981 to 355 in fiscal 1982.

(1) identifies the relative priority each adviser should have, in terms of frequency of inspections, based upon certain client and asset-under-management data; and (2) determines the relative risk inherent in each adviser's operations to guide the scope of the inspection procedures used by examiners.

These new streamlined procedures have worked very well. Based on the findings of the inspections completed during fiscal 1982, the staff found it necessary to take some sort of remedial action in 77% of the cases. This percentage is about 15 percentage points higher than the percentages for the preceding two years. The use of the new selection and risk appraisal techniques resulted in our being able to increase the number of inspections without reducing either the effectiveness of the inspection program or the level of investor protection it affords.

2. Prospectus Simplification

During fiscal 1982, the Division of Investment Management made substantial progress on a major project, the re-examination of the investment company prospectus. The goal of this project is to make the prospectus a document that will permit individuals to readily understand the essential characteristics of the fund in which they are considering an investment - a change from current prospectuses which have become enormously over-grown and expensive. The simplified prospectus would highlight the fundamental features of the investment, such as the name of the investment adviser, the fund's current objectives and policies, how shares may be purchased and redeemed, and the fund's investment performance shown on a per share basis over time. Most of the "legalese" now contained in the prospectus would be transferred to a "statement of additional information" that would be available to prospective investors upon request and without charge.

Shortly after the close of the fiscal year, on December 21, 1982, the Commission published for public comment the first of its anticipated prospectus simplification proposals. The proposal would replace the current registration statement form used by open-end management investment companies, for all such companies other than insurance company separate accounts, and could result in a reduction in the length of the prospectus from about 25-30 to no more than 8-12 pages.

3. Rules 487 and 486

On May 7, 1982, the Commission adopted Rule 487 under the Securities Act of 1933 (Securities Act Release No. 6401). Rule 487 permits most registration statements filed by unit investment trust series to become effective automatically, on a date and at a time designated by the registrant if certain conditions specified in the rule are met. Generally, automatic effectiveness is available for a registation statement filed with respect to the securities of a new series of a trust, if the registrant represents that the disclosures in the registration statement do not differ in any material respect from those contained in the effective registration statement of one or more specifically identified previous series of the trust, except to the extent such differences are necessary to identify the specific portfolio securities of, and to provide essential financial information for, the series being registered. The rule eliminates review of registration statements of unit investment trust series that differ from one another only with respect to the specific composition of the portfolio, and thus do not present disclosure issues that require staff review and comment prior to effectiveness of the registration statement.

The Commission adopted another rule under the Securities Act for automatic effectiveness of investment company filings, Rule 486, on May 14, 1982 (Securities Act Release No. 6402). Rule 486 permits most post-effective amendments to registration statements filed by registered separate acccounts of insurance companies to become effective automatically either on the date of filing or on a date no later than 80 days after filing. The rule eliminates staff review of most routine filings by insurance company separate accounts.

4. "Start-up" Applications

Most insurance company separate accounts apply to the Commission for certain so-called "start-up" exemptive relief in connection with registration of the separate account and the securities it is to issue. In many respects, the staff's consideration of these applications and the later grant of the requested exemptive relief have become routine. The Division of Investment Management, therefore, has planned a series of proposals which would codify the standards that have been developed with respect to "start-up" applications; the first rule in this series, Rule 11a-2, was proposed on September 20, 1982 (Investment Company Act Release No. 12675). Rule 11a-2 would eliminate the need for separate accounts and others to file individual applications seeking approval of the terms of certain routine change offers.

Public Utility Holding Company Act of 1935

Under the Public Utility Holding Company Act of 1935 ("Holding Company Act"), the Commission regulates interstate public utility holding company systems engaged in the electric utility business or in the retail distribution of gas. The Commission's jurisdiction also covers the natural gas pipeline companies and non-utility companies which are either subsidiaries of operating utilities within a registered holding company system or of registered holding companies. There are presently 13 registered holding companies with aggregate assets, as of June 30, 1982, of $62.9 billion.

The Holding Company Act was originally designed to effect a restructuring of the gas and electric utility industry and to prevent recurrence of the abuses caused by multi-tiered utility holding companies. The Commission has achieved these purposes and most of the industry has been geographically integrated and simplified. Developments since 1935 in the form of new accounting standards, sophisticated financial analysis and increased disclosure requirements all ensure the soundness of the utility industry and the protection of utility investors. Moreover, in many respects the Holding Company Act duplicates, for a small segment of the utility industry, the functions of the Federal Energy Regulatory Commission and the state commissions, while the effective reach of both state and federal utility regulation has greatly increased since 1935.

These changes since the Act's passage have led to its reconsideration. Eight bills proposing modifications to or repeal of the Holding Company Act were introduced in the 97th Congress. Three of the bills would have repealed the Holding Company Act; another bill proposed substantial amendments to the substantive provisions of the Act relating to financings, non-utility acquisitions and affiliate transactions by registered holding company systems. Two other bills would have amended Section 3 of the Act to entitle additional categories of holding companies to a general exemption. In addition, they would have required the Commission to grant an unqualified exemption from all provisions of the Holding Company Act (except Section 9(a)(2), which concerns acquisitions of public utility companies) to holding companies which meet the enlarged categories for exemption. The last two bills would in effect have removed gas utility companies from the Holding Company Act as long as they were owned or controlled by an issuer of a class of securities registered under Section 12 of the Securities Exchange Act. At hearings held to consider these bills, the Commission supported repeal of the Holding Company Act, stating that the Act was, in fact, no longer necessary to fulfill its original purposes.

SECO, MSRB and Housekeeping Legislation

H.R. 562, that was introduced at the request of the SEC, would terminate the Commission's direct regulation of a small fraction of the over-the-counter broker-dealer community known as SECO broker-dealers. This bill would require those broker-dealers to join the self-regulatory system applicable to the vast majority of the over-the-counter industry.

In 1964 a significant number of over-the-counter firms had avoided the regulatory responsibilities assumed by the rest of the broker-dealer industry by choosing not to join a national securities association, the National Association of Securities Dealers, Inc. ("NASD"), this organization being then as now the only association in existence. Congress therefore proposed that membership in a national securities association be mandatory for all broker-dealers transacting business in the over-the-counter market in order to assure uniform standards of investor protection.

Instead, the SECO alternative was adopted in 1964, giving over-the-counter broker-dealers a choice of regulatory formats. Currently, only 12% of the eligible active registered broker-dealers have chosen the SECO alternative. One reason for the SECO alternative was the belief of a few broker-dealers affiliated with insurance firms who sold investment company shares that the NASD was dominated by traditional brokerage firms who would not be sensitive to the specialized needs of the insurance firms. These concerns are no longer justified.

Since 1964 the NASD has been able to accommodate diverse industry product interests into its membership structure including the majority of insurance companies and retailers selling investment company shares. Furthermore, insurance companies who feared self-regulation by an organization they perceived as dominated by Wall Street brokerage firms are now themselves part of such organizations and no longer see their financial survival as being put at risk by NASD membership given the changes in the composition of the securities industry and the Commission's extensive oversight of the NASD. Moreover, the desirability of self-regulation, which Congress reaffirmed in 1975, offers a number of clear regulatory advantages which are in place for the vast majority of the broker-dealer industry and are equally appropriate for those firms currently in the SECO program.

The Commission's decision to recommend abolition of the SECO program is based on a comprehensive management study of the SECO program that concluded that the program imposes unnecessary costs on the Commission by diverting its limited resources away from areas of major concern in order to duplicate the self-regulatory activities of the NASD. The study concluded that the SECO program would, in the future, require even greater expenditures of staff time and resources beyond current spending levels to ensure that SECO and NASD firms are subject to equal regulation. At a time when the Commission is seeking to respond to the rapid changes in the securities industry while being conscious of budgetary constraints, it must allocate scarce resources to areas of more importance to investor protection.

There is, in addition, an even more compelling rationale behind the Commission's recommendation: in many areas self-regulation is preferable to government regulation. SROs are better able than the Commission to establish and maintain ethical standards of behavior for persons in the securities industry. Further, SROs are often capable of providing oversight of their members' conduct in areas where the Commission cannot operate or cannot operate as efficiently as the self-regulatory organizations. We believe, therefore, that broker-dealers transacting over-the counter business should be required to join a registered securities association. The option of continued SECO regulation is costly to the Commission, unnecessary for the securities industry and detrimental to the interests of the investing public.

There are indications that our recommendation will receive substantial support in the SECO community. The Commission and the NASD have worked together to develop a program under which the NASD has agreed to waive initial membership fees, qualifications exams in most instances and to minimize initial filing requirements for SECO broker-dealers who voluntarily convert to NASD membership. Since NASD members and SECO broker-dealers have been subject to basically the same regulatory requirements and financial assessments, the transfer to NASD membership will not involve a hardship for SECO broker-dealers. The voluntary conversion program has been well received. The three largest SECO broker-dealers have decided to convert to NASD membership. With the transfer of just these two firms to the NASD, the number of persons requlated by the SECO Program will drop dramatically from approximately 18,000 to approximately 3,000. Consequently, the SECO Program now will involve the regulation of an even smaller part of the industry and will be an even more questionable allocation of Commission resources.

The Municipal Securities Rulemaking Board ("Board") is seeking legislation to expand the number of individuals eligible to serve as a "public representative" on the Board. Section 15B of the Securities Exchange Act currently provides that five of the 15 Board members shall be public representatives and that at least one be representative of investors and at least one be representative of issuers of municipal securities. Currently, no public representative may be associated with any broker, dealer or municipal securities dealer.

The proposed legislation would permit a person who is associated with a broker or dealer, other than a municipal securities broker or municipal securities dealer, to serve as a public representative. Such a change will permit persons associated with insurance companies and investment advisers to serve as public representatives even though their companies have an affiliated broker or dealer organization. The Commission supports this legislative initiative as one means of ensuring that all segments of the investment community have an opportunity to be represented on the Board by capable and knowledgeable persons. Moreover, we believe that retention of the prohibition that no public representative associated with a broker or dealer which participates in the municipal securities business is sufficient to ensure the independence of public members serving on the Board.

Another proposal is to amend the Securities Exchange Act to give the Commission the authority to accept payment and reimbursement from outside sources for travel and subsistence expenses incurred by Commission members or employees who participate in meetings and conferences on securities regulation and related topics. To the extent Commission members and employees have been able to participate in these events in the past, the result, we believe, has been better administration of the securities laws because of a better informed industry, securities bar and public.

The legislation would put the Commission on an equal footing with other agencies which have such authority, e.g., the Departments of Energy and Transportation and the Securities Investor Protection Corporation. The legislation is needed because, in the absence of such authority, reimbursement to Commission members and employees who participate is limited to certain narrow situations recognized by the Comptroller General as exceptions to the prohibition against government officers and employees receiving contributions to or supplements of their salaries. While one of these exceptions has permitted Commission employees to participate, Commissioners generally have been unable to rely on this exception.

The legislation would clearly permit both Commission members and employees to participate in a procedure under which private sources would donate the cost to the Commission. No direct payment would be made to any individual. The amount received would be credited to the Commission's appropriation, and the member or employee would be paid by the Commission. Finally, the Commission would be directed to adopt rules, which, in conjunction with existing rules, would elimininate any real or apparent conflict of interest that may arise.

Another recommended change in the Securities Exchange Act would permit the payment of relocation expenses to Washington, D.C. for participants in the Commission's Fellows programs by the Fellows' former private sector employers. The current restrictions on the payment of such expenses are an impediment to attracting the most able persons as applicants. In 1979, Congress relieved these restrictions as they apply to executive agencies, but the amendment was phrased so as to deny Commission fellows the same treatment. The proposed amendment would cure this anomaly. Of course, the Commission will continue to structure the Fellows programs to avoid conflicts of interest. Enactment of this proposal would encourage the most able applicants to accept.

* * *

A copy of a letter dated March 15, 1983 from Commissioners Evans, Thomas, Longstreth, and Treadway to Congressman

Timothy E. Wirth, Chairman of the House Subcommittee on Telecommunications, Consumer Protection and Finance, is attached, concerning the needed staffing levels for fiscal 1984.

The Commission would be pleased to respond to any questions.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

March 18, 1983

The Honorable Timothy E. Wirth
Chairman
Subcommittee on Telecommunications,
  Consumer Protection and Finance
House of Representatives
Washington, D.C. 20515

Dear Chairman Wirth:

As you requested at the authorization hearing on February 15, 1983, we have undertaken a detailed, independent review of the Commission's budgetary needs for fiscal year 1984. We have concluded that a 6% cut in staff positions would make it exceedingly difficult to maintain a satisfactory presence in each of the important areas of our responsibility. At the present funding level, we are stretched thin -- so thin, in fact, that we have concluded it is the minimum responsible staffing level. To keep pace with the rapidly changing industry we regulate, we believe that a substantial increase would be in the public interest. Our consensus is that a 4% increase in staff positions, to be allocated as indicated on the attached table, is necessary. A concomitant increase of staff years and dollars would, of course, be necessary.

In contrast with the budget figures submitted by the Commission for the authorization and appropriation hearings, these figures, as you requested, were not determined by fiscal policy considerations. Nor do they reflect possible legislation, such as Glass-Steagall amendments, that could impact on the resources needed to carry out our responsibilities. They do, however, reflect our assessment of the work to be done, which is steadily increasing, and the productivity gains that can reasonably be achieved in fiscal year 1984.

A brief summary of the reasons for our determination follows.

Full Disclosure

We believe the Commission must continue to review virtually all first-time registration statements. We should also increase the number of annual reports selectively reviewed, since that document is the core of the integrated disclosure system. In addition, it is appropriate to assure prompt and comprehensive review of small issue filings in our

The Honorable Timothy E. Wirth
March 18, 1983
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regional offices in order to reduce the need for enforcement action. We also must maintain close scrutiny of proxy contests and tender offers.

Prevention and Supression
of Fraud and Legal Services

The competence of the Commission staff and quality of the Commission's enforcement program sets a standard of excellence in government. We believe that additional resources are necessary to maintain this standard in light of the increasing level of complexity in enforcement actions, particularly in the financial fraud and market manipulation areas, and the increase in the use of litigation tactics to delay those actions.

Regulation of Securities Markets
and Investment Management Regulation

As the securities industry becomes more competitive, the changes in these areas are accelerating. It is necessary to increase staff resources in the home office divisions to keep regulation reasonably current with changes in the marketplace. In the regional offices, the examination programs account for 19% of enforcement leads. It is essential that this enforcement feeder system be maintained to oversee the conduct of securities professionals.

Other Programs

The Commission's other programs do not require substantial increases in staff, but they are important to the functioning of the Commission and cannot be stripped of their resources to meet the needs outlined above.

* * *

We would be happy to go into greater detail on methodology or the basis for any of our recommendations should you wish us to do so.

Sincerely,

John R. Evans
Bevis Longstreth

Barbara S. Thomas
James C. Treadway, Jr.

SECURITIES AND EXCHANGE COMMISSION
FY 1984 STAFFING PROPOSALS

	Staff Positions			Our Proposed FY 84 Staff Positions
Program	FY 82 (Actual)	FY 83 (Approved)	FY 84 (Submitted)	
Full Disclosure	443	444	417	472
Prevention & Suppression of Fraud	638	640	608	663
Regulation of Securities Markets	267	264	246	275
Public Utility Holding Company Regulation	21	21	19	21
Investment Management Regulation	200	200	188	214
Legal Services	142	143	131	145
Economic & Statistical Research	45	44	38	44
Program Direction	265	265	249	265
	2,021	2,021	1,896	2,099

	Budgeted Staff Allocations			Our Proposed Staff Allocations
Full Disclosure	21.9%	21.9%	22.0%	22.5%
Prevention & Suppression of Fraud	31.6	31.6	32.1	31.6
Regulation of Securities Markets	13.2	13.1	13.0	13.1
Public Utility Holding Company Regulation	1.0	1.0	1.0	1.0
Investment Management Regulation	10.0	10.0	9.9	10.2
Legal Services	7.0	7.1	6.9	6.9
Economic & Statistical Research	2.2	2.2	2.0	2.1
Program Direction	13.1	13.1	13.1	12.6
	100.0%	100.0%	100.0%	100.0%

Mr. SHAD. Major programs brought to fruition last year are intended to provide the most benefit to shareholders at the least cost to them, their corporations, and the government.

EFFICACY OF COMMISSION

Fiscal year 1982 was an exceptional year in terms of the volume and efficacy of the Commission's efforts in the reduction of regulatory burdens.

Briefly, the Commission brought 30 percent more enforcement cases, conducted 25 percent more investment company and adviser inspections, processed 8 percent more broker-dealer reports, and handled 5 percent more full disclosure documents than in fiscal 1981 with 5 percent less personnel.

Registration and other fees offset 94 percent of the Commission's $83 million budget as compared with 81 percent in 1981.

The following were records or the highest levels in several years. 250 enforcement cases were brought, 1,000 investment company and advisory inspections were conducted, 6,600 broker-dealer reports were processed, and 65,000 full disclosure documents were handled. The Commission also obtained disgorgements and restitutions for $33 million, rescission offers and refunds of $53 million and asset freezes of $36 million.

Major programs brought to fruition last year have reduced corporations, and therefore their shareholders, expenses by several hundred million dollars per annum, as well as the Commission's paperwork, but not investor protections.

For example, integration of the registration and reporting requirements under the 1933 and 1934 Securities Acts is one of the most important improvements in the securities laws since they were enacted half a century ago. For the benefit of shareholders, integration increases their corporations' financing flexibility and reduces their expenses by over $350 million per annum, as well as the Commission's paperwork, but not public disclosures.

In another area, over $500 million of the securities industry's capital was freed up by updating the net capital requirements to take into account the industry's improved financial and operational conditions. This additional capital has helped the investment bankers and brokers to handle the much greater volume of financings and transactions since last August and to improve other services to investors.

In addition, certain offerings up to $5 million to others than the general public were exempted from registration. Private placement exemptions were also simplified and improved. Most States are expected to adopt exemptions which will be the first joint State and Federal registration exemptions.

SHELF REGISTRATION RULE

The temporary shelf registration rule permits corporations to file a single registration statement covering securities they expect to sell from time to time within 2 years.

Over $40 billion of securities have been registered under the shelf rule since a year ago, last March, when it was authorized.

Later this year the Commission will determine whether to extend, modify or withdraw the shelf rule.

The historic accord concluded when Switzerland removed the haven of Swiss secrecy laws from those who would trade on inside information.

The accord concluded with the Commodity Futures Trading Commission resolved a 7-year jurisdictional dispute and enabled the SEC to authorize trading in Treasury, GNMA, foreign currency, certificates of deposit, and stock index options, which will facilitate government and mortgage financings, international trade and hedging the risk of fluctuating interest rates in securities markets.

With reference to the national market system, the Exchange and over-the-counter markets in 30 stocks have been electronically linked, and last sales of 184 national securities market and over-the-counter stocks are now being reported on a real time basis.

Greater reliance is also being placed on private sector self-regulation under the SEC's oversight. The 428 accounting firms which audit over 90 percent of publicly owned corporations are now on a 3-year peer review cycle, and the stock exchanges are enhancing their electronic intermarket surveillance systems and audit trails.

These measures facilitate the identification of possible insider trading.

The Commission is also spending more time listening and responding to the needs and interests of investors, corporations, and others. During the past 12 months, the Commission has held the first research forum in which leading security analysts recommended improvements in the SEC disclosure and rulemaking practices; the first round of meetings with other agencies with which the SEC has overlapping jurisdiction—the Federal Reserve Board, the Comptroller of the Currency, the FDIC, the Federal Home Loan Bank Board, and the Commodity Futures Trading Commission; the first government-business forum on small business capital formation; a conference on major issues confronting financial institutions and markets for the 1980's; and an international conference with securities regulators from 31 nations.

In congressional testimony and speeches, the Commission has advocated for over a year the formation of a task force to help simplify and improve the regulatory structures of the financial services industries and capital markets for the benefit of investors and depositors. Vice President Bush has recently formed a task force for this purpose.

In addition to the SEC-CFTC accord which was enacted last year, the Commission has proposed legislation to increase criminal fines from $10,000 to $100,000, to permit civil fines of up to three times insider trader profits, to require over-the-counter broker-dealers to join a registered self-regulatory organization, and to repeal the Public Utility Holding Company Act.

The Commission also testified in support of the amendments to the Glass-Steagall, Foreign Corrupt Practices, and the Bankruptcy Reform Acts.

Many had a part in last year's record results, but they are principally a tribute to the dedicated efforts of the outstanding SEC staff. This year the Commission will be studying the tender offer rules, the adequacy of its enforcement remedies, means to further automate its automatic data processing requirements, and the rapidly changing domestic and international securities markets.

The Commission also expects to implement proposed improvements in the proxy rules, corporations ability to communicate with their shareholders, and investment company prospectuses.

Thank you very much.

Senator D'AMATO. Thank you, Mr. Chairman.

Let me ask you, what was your authorized level for 1983?

Mr. SHAD. One hundred and seven million dollars.

Senator D'AMATO. Was that $107 million?

Mr. SHAD. That's what we're requesting—authorized level—I'm sorry. I'd ask George Kundahl to join me, who's the Executive Director. The authorized level for 1983 is $106.6 million.

Senator D'AMATO. What was the appropriated level?

Mr. SHAD. Eighty-eight million dollars, under the continuing resolution.

Senator D'AMATO. What is your request for fiscal year 1984? Would you touch on what you're requesting for 1984, 1985 and 1986?

Mr. SHAD. Yes. $99.1, $107.6, and $117.7 million.

Senator D'AMATO. The basic question that comes to mind is will this level of authorization—$99, $107.6, $117.7 million—will that give the Commission the ability to discharge its responsibilities as you have outlined them in view of the increase in terms of numbers of issues, number of people participating, number of new brokers coming into the field? Will this give the Commission the ability to discharge its responsibilities in the manner that it has in the past?

Mr. SHAD. I'd like to give a full response to that.

Senator D'AMATO. Certainly. That's really the guts of this whole hearing. When we cut through all the niceties, the fact of the matter is that we are interested in ascertaining whether or not this appropriation request, will be sufficient to maintain the level of SEC activities and the quality of SEC activity that has heretofor been discharged, or will it impair the ability of the Commission to undertake those responsibilities that the public and the Congress have come to expect?

Mr. SHAD. I have prepared, as a matter of fact, an addendum to my testimony, which at this point I would appreciate being included in the record, which gives a full response to that very important question.

Senator D'AMATO. So ordered.

[Addendum to Mr. Shad's statement can be found on p. 132.]

Mr. SHAD. I can highlight it now if you like. The SEC could, of course, do more with more money. I think it's doing an excellent job with the money it presently has and the personnel it has. However, I do believe that the Commission can maintain its present levels of activity despite a 6-percent personnel reduction in fiscal 1984 for the following specific reasons.

Just to boil it all down, our staff is doing an outstanding job of improving the productivity of their divisions. They're top-rate managers, and so the Commission is improving its productivity at all levels as a result of ongoing efforts by the Division Directors, the Executive Director—and it goes all the way down into the lower offices and people on the job. It's a very intelligent, highly motivated staff; they're coming up with ways to do things better all the time, and it's for this reason that programs initiated by the staff as well as others over the past year are expected to increase the Commission's fiscal 1984 productivity sufficiently to offset a 6-percent reduction in personnel.

FULL DISCLOSURE

I'm only going to highlight the programs involved because I have an 18-page memorandum; I'll just tick off a few of the most important improvements. In the area of full disclosure, which is basically under the direction of Lee Spencer and John Huber, as well as other senior members of that group—that's the Corporation Finance Division: During the past year over 70 percent of the 9,000 publicly owned companies have begun to be screened by computers that identify possible problem areas and tabulate key ratios and trends. So a lot of what was done manually is now being done by high speed electronics. I think the exact number was 72 percent of publicly owned companies.

In addition, over 700 additional companies will be programed in this fiscal year and most of the balance are expected to be added within 12 months.

Senator D'AMATO. What you're saying is that as a result of the increased use of computer technology, man-hours that would have been spent routinely, pulling out files of companies and looking at reports, have now been reduced substantially as a result of utilizing computers and other sophisticated equipment?

Mr. SHAD. That's exactly right, and a lot of the work is being done for us by an organization known as Compustat and others that prepare tapes that have enormous detail on publicly owned companies. Much of whatever they file with the SEC is put on these tapes by private organizations.

Senator D'AMATO. Would you say that the quality of that review has been enhanced as a result of the use of this equipment or has remained at the same level?

Mr. SHAD. I'll come to other reasons why I believe the quality of review has been improved, but I think that what the computers do is quickly identify red flags, areas that do require further inquiry. The quality of the review is a function of the staff itself, and in that respect there are now teams of industry specialists and also teams that cover special areas, which is a reorganization, if you will, of the way these reviews are conducted.

So we have under Mr. Spencer, 26 teams that are specialists. Before when a filing came in it was assigned to someone who may have known very little about an oil company or a steel company or an electronic company to use these as examples. So this organizational change has been important in terms of improving quality as well as efficiency. When you have real specialists reviewing these financial statements and complicated filings, they know what's important and they know where to go, and they have been through it with the same companies in the past.

The other area of improvement in quality is another management initiative by Mr. Spencer and the senior members of the Corporation Financial Division which is to set up a bonus system that provides incentives both as to quantity and quality—in fact, quality is heavily weighted.

Senator D'AMATO. A bonus system?

Mr. SHAD. Yes. It's modest in terms of dollars but significant in terms of recognition, and it provides an incentive for the staff to do a first-rate job in terms of quality as well as quantity.

Senator D'AMATO. I really should have asked this question first. I understand and I don't want you to be repetitive and go through some of these things that you have just keyed on, but obviously one of the reasons for my concern is the fact that four of the Commissioners, by way of letter to one of the House subcommittees that has oversight of the SEC, indicated that they felt that there would be need for a 4 percent staff increase in order to keep up with the workload.

Can you explain this? Is this at variance with what you're indicating?

Mr. SHAD. Yes, there is a variance and yet I'd say the difference in perspective between that letter and what I'd like to continue to outline is you will find a very brief reference to improved productivity in that letter. I think that's a very important missing element in their review. I don't believe that they went to the depths of analysis of the improving productivity within the divisions that is a very important factor. I wouldn't argue with their fundamental statement which is that obviously we can do more with more money and people.

Senator D'AMATO. And the second question is, Do you find a necessity for that?

Mr. SHAD. Pardon?

Senator D'AMATO. Do you find a necessity for that? The question is, Do you find a necessity to say, yes, we can do more, Senator, with more staff and more people? Are there certain areas or certain levels of activity that should be undertaken that you would like to undertake given your druthers?

Mr. SHAD. Senator D'Amato, one of the missing facts in this terribly important area that I've asked and tried to come up with but I have not found any significant source for, basically is, what is the magnitude of securities crime in America? And, of course, we don't know the level of undetected violations of the securities laws.

Senator D'AMATO. We're going to give you a new area and clearly give it to you because we did introduce that bill on behalf of not only myself and the Commission but a number of other Senators—Senator Proxmire, Senator Sarbanes and Senator Garn—dealing with increased penalties for those who trade common stock and options on insider information.

Mr. SHAD. Well, that is very extremely helpful. That will inhibit inside trading. But it doesn't identify the magnitude of the problem. In order to give you an intelligent answer to that profound question——

Senator D'AMATO. Well, do you need some more investigators in this area? Do you need more researchers in this area?

SECURITY VIOLATIONS IN AMERICA

Mr. SHAD. It's not a question of investigators. The question is, What is the order of magnitude of securities violations in America? That's a very amorphous subject to try to address. We don't know. I could ask even a broader question, what's the level of crime in America? The FBI has done various studies and reports and come up with some quantification of the level of violation in particular areas. We don't know in the securities field.

Senator D'AMATO. I think that the level of money spent on enforcement to deal with the crime problem from the Federal level on down is totally inadequate and that by proper allocation of resources we could substantially improve the quality of life. I fight for mass transit for our city, New York, and yet when I ride on the subway I'm afraid even though I have a guard with me, because I find out he's afraid to ride on the subway, too. And that's why the level in terms of the quality, and in terms of the number of riders, et cetera, has gone down.

So in terms of trying to quantify where it is, the SEC has basically an excellent reputation in terms of its enforcement. If indeed there will have to be a staff reduction to deal with the appropriations requested, I think it raises in the minds of many of us whether or not there will be a reduction in the level and in the quality of effort and the quality of scrutiny.

Mr. SHAD. Could I give a short answer to that? I have been trying to give a long one. I don't believe a 6 percent reduction will result in a given percentage reduction in the level or the quality of our effectiveness in discouraging securities violations. I suspect, in the absence of hard facts, that the total volume of undetected crime in America is a very large number; the FBI and the various legal agencies penetrate only certain degrees or percentages, as does the SEC within the securities area. I really think on a relative basis, whether the staff is down 6 percent or up 4 percent is probably a very minor percentage of the total impact on this entire area.

The important thing, I believe, is the visibility of the Commission, because I believe the visibility of the law enforcement efforts of the Commission inhibits—it has a prophylactic value that's enormous.

Senator D'AMATO. Let's talk about the Commission and its activities. What is the level in terms of cases, over the past several years? Is the number of prosecutions, the number of cases involved increasing? We did touch on that and I gave you some of the statistics in terms of new dealers, new activities, number of shareholders, et cetera, but what about in that law enforcement area? Do you have any statistics that would indicate what the level is?

Mr. SHAD. Yes. Well, last year was a record. Based on what we have in terms of figures, it's either a record or the highest in several years, and last year the Enforcement Division—the Commission brought 251 cases, over a 30 percent increase over the prior year, with 5 percent fewer personnel. So it's obvious that personnel up or down is not the controlling factor on the impact and volume of enforcement actions.

Senator D'AMATO. Why don't we be a little more precise and restrict that to moderate levels of change at personnel levels?

Mr. SHAD. Yes, yes.

Senator D'AMATO. OK. Because, obviously, if we get into drastic personnel reductions there may indeed be an impact.

Mr. SHAD. Right. I haven't mentioned a number of other areas and perhaps, without going into detail, I could just mention the categories. In addition to the rapid improvement that's going on at the Commission at all levels within all the divisions in terms of the use of computers—and we've got a long way to go; I'd say we're about 50 percent in terms of the present state of the art, and of course the art is constantly improving.

Senator D'AMATO. So you've seen an improvement in this area over the years?

Mr. SHAD. Yes.

GREATER AUTOMATION

Senator D'AMATO. Greater automation?

Mr. SHAD. Yes. And a lot more room for future improvement. Paperwork reductions. Integration, as I mentioned in my opening statement, is one of the most important improvements in the securities laws since they were enacted a half a century ago. It takes prospectuses that were running 50 to 100 pages and brings them down to 5 to 10 pages. This is an enormous reduction in paperwork.

The shelf-registration, the exemptions, regulation D, which completely removes from the SEC's enforcement jurisdiction, other than for fraud, a huge category of financings of less than $5 million to others than the public that are expected to exceed $4 billion this year. That's material we don't have to review in the normal course of filings.

With regard to the self-regulatory organizations, we now have peer review of the accounting profession, which is a tremendous surveillance system, in an effort to upgrade accounting standards as well as the efforts that are ongoing right now by the other self-regulatory organizations to electronically surveill the intermarket. They're already surveilling the existing markets, but now we want the computers basically and the individuals responsible to start talking to one another. So, for example, they are aware of what's going on in the options market in terms of the underlying stock market or vice versa. These are interrelated situations and you can manipulate one market to get a benefit in the other.

We've proposed legislation to require all the SECO firms which are directly being inspected by the SEC today to join a national self-regulatory organization. Even without that legislation's being enacted they're already signing up in anticipation. They're doing it voluntarily; those SECO firms which account for about two-thirds of all the account executives within that group have already voluntarily signed up. That will significantly relieve the direct examination requirements and responsibilities of the Commission. It will be handled by the NASD.

Senator D'AMATO. Let me ask you about an area in which I think you would have a little more difficulty utilizing these same techniques that we've talked about, like computerization, et cetera.

If in fact the Commission looks forward to an increase in filings of registration statements, and annual reports proxy materials, and there is an increase in all of these areas, how will you allocate staff to handle this increase and see to it that the same quality level of review, plus the expeditious treatment which is most important is maintained?

Mr. SHAD. It's a very time-consuming process that the Commission goes through to reach those decisions. Each division——

Senator D'AMATO. But that's an area of our concern.

Mr. SHAD. Pardon?

Senator D'AMATO. That's an area of this committee's concern. We are concerned as to whether or not each division is adquately staffed. When considering the SEC's level of staffing I find it relevant that 90 percent of the SEC's budget comes by way of fees—is that not the case?

BUDGET BY WAY OF FEES

Mr. SHAD. Ninety-four percent last year.

Senator D'AMATO. Ninety-four percent. Now let me ask you something else. Are there areas where the Commission might implement modest fee restructuring in order to keep pace with actual costs, therefore it might even be possible to increase that 94-percent figure without doing violence to the system that we have? Of course, overtaxation is about to destroy us and we don't want to see that take place either by making the fee structure burdensome. Of course, Mr. Stockman would probably want to double or triple the fees, that's my own observation. Do you have any ideas on that?

Mr. SHAD. Of the fees, about two-thirds of them are registration fees when people file registration statements with the SEC.

Senator D'AMATO. When was the last time there was any change to those registration fees?

Mr. SHAD. Well, they're a percentage, so they fluctuate with the volume of filings. They're on a percentage basis. The percentage itself hasn't changed for years.

Senator D'AMATO. What percentage is that?

Mr. SHAD. It gets down to about 20 one-thousandths of 1 percent.

Senator D'AMATO. So a very, very minute change in that area might derive revenues sufficient to even have a carrying effect, so that instead of 94 it could be up to 100?

Mr. SHAD. Let me go on. I'd rather identify where the fees are and where they are not so you might have——

Senator D'AMATO. I'm not suggesting areas that you impose fees. I'm asking whether you have reviewed the fee structure so as to see, for example, if you have a fee that was set at a certain percentage, 10 or 15, or 20 years ago that might by way of some fine-tuning generate more revenues. I'm not suggesting a prohibitive increase—we had a suggestion, for example, that the State of New York institute a stock transfer tax. Such a tax would have had a devastating effect on the industry. I'm not suggesting the kind of situation that would bring down the house of cards, but have you reviewed the fee structures so that more outside revenues, might be produced without doing any damage.

Mr. **Shad**. Yes, and Mr. Kundahl just provided me with a copy of a letter to Senator Garn on May 2, 1980 which was the year before I arrived on the scene, which is fairly voluminous and does contain a fee study that was provided at the request of the Senate Banking Committee.

Senator D'**Amato**. I think it's rather important that we have an update with respect to that and not rely on information from May 1980.

Mr. **Shad**. The latest update was a report to Congressman Dingell in January 1982. It's 1 year old. The fees that we collect now, as I started to say, are two-thirds of our registration statements, approximately 25 percent of them come from transfer fees on the listed markets, on the exchanges, and the balance are miscellaneous.

There are no transfer fees at the present time on over-the-counter transactions in unlisted stocks, which are very large in volume. One of the problems is collection. Obviously when you're getting to fees that are fractions of—it's but it's less than three one-hundredths of 1 percent—when you get down to that level, the collection process, even in this automated age, can be as much as the fee.

Another important area where fees are diminimus is in the area of proxies and tender offers, these huge tender offers——

Senator D'**Amato**. Boy, that might be an area to stop some of these guys from throwing away money.

Mr. **Shad**. So there are a number of areas that we——

Senator D'**Amato**. I think it is important for you to submit to this committee an up-to-date overview with some possible suggestions. Again, this would be with the view toward nonimpairment of the industry—we're talking about possibly several millions of dollars in a multibillion industry. I'm not trying to make profits for the Government, but it seems that we're so marginally close to even carrying it at 100 percent that it might even put you in a position to increase the computerization, the streamlining, and to help in the efficiency of that operation, where we would be able to produce additional revenues in this area. So I think that would be helpful to the committee and I would ask you to please move forward on that update.

Senator Sarbanes.

Senator **Sarbanes**. Thank you, Mr. Chairman.

Chairman Shad, welcome before us. Mr. Chairman, I assume we're going to alternate back and forth as we proceed.

Senator D'**Amato**. Well, I've had the opportunity for just about the past 25 minutes or so to try to get an overview and go into some detail, and I think you could take a free hand on this.

Senator **Sarbanes**. When you think I've gone on long enough and you want to come back, why don't you just let me know because I may be here a while, Mr. Chairman.

Senator D'**Amato**. OK. You were up late last night, too.

STATEMENT OF SENATOR SARBANES

Senator **Sarbanes**. I was, but I'm back at it this morning.

Mr. Chairman, I want to make just a brief statement at the outset.

This year and next year mark the 50th anniversary of the enactment of the landmark and fundamental legislation in the securities area and I think that the issues as we undertake this authorization before us are clear.

First, is the Commission performing properly and effectively its essential responsibilities to protect the investors and insure the integrity of our capital markets as envisioned by the Congress under the securities law? I happen to think that the integrity of our capital markets is a very important dimension to our general economic strength, that those markets are really the best in the world and it's extremely important to keep them that way.

Second, what authorization is needed to enable the Securities and Exchange Commission to do its job responsibly and effectively? Now that job includes, among other things, compelling full and fair disclosure to investors of all the material facts relating to new securities issues publicly offered or sold, correcting unfair practices in the securities market, including the prevention and suppression of fraud, furnishing to the public adequate information concerning the management and financial condition of corporations whose securities are traded on the exchanges, and better supervising the national traffic in investment securities in the purchase and sale of all property dealt with on exchanges.

When the Securities Act of 1933 was signed 50 years ago, President Roosevelt issued a statement, and I'm quoting:

> This law and its effective administration are steps in a program to restore some old-fashioned standards of rectitude. Without such an ethical foundation, economic well-being cannot be achieved.

I happen to believe that that statement is as applicable today as it was in 1933 and in fact I think that the hearing you held earlier this week, Mr. Chairman, served to underscore how important a role there is for the Securities and Exchange Commission to play in insuring some of these old-fashioned values, as well as safeguarding and protecting public confidence in our financial markets.

With respect to today's budget authorization request, I would be less than candid if I did not indicate that I'm disturbed by the fact that four out of five of the Commissioners have publicly stated their view that a substantial increase in the Commission's budget would be in the public interest and "is needed."

Such a budget, of course, has not been proposed and therefore I look forward, Mr. Chairman, to taking a hard look to review that the real needs of the Commission are satisfied.

Chairman Shad, as I understand it, the Commissioners are appointed one a year, is that correct?

Mr. SHAD. Yes, sir.

Senator SARBANES. In June of each year, is that when the term expires?

Mr. SHAD. June 5.

Senator SARBANES. And there's also under the law a party requirement, is that correct?

Mr. SHAD. Yes.

Senator SARBANES. Which is what?

Mr. SHAD. Not more than three from one party, whichever that might be. Right now there are three Republicans and two Democrats on the Commission.

Senator SARBANES. Now that means that a newly elected President would not have appointed a majority of the Commissioners until June 5 of the third year of his 4-year term, is that correct?

Mr. SHAD. Well, it doesn't work out that way because of the turnover. The average service of members on the Commission I believe is about 2.4 years—you can have constant a number of resignations and——

Senator SARBANES. I understand that, but in terms of the statutory scheme, assuming each Commissioner serves his term, a newly elected President would not have appointed a majority of the Commissioners until June 5 of the third of his 4-year term, is that correct?

Mr. SHAD. Yes, it is.

Senator SARBANES. What do you understand the position of the Securities and Exchange Commission to be in the Government of the United States in terms of its relationship to the executive and legislative branches?

Mr. SHAD. It's apolitical.

Senator SARBANES. Well, I would accept that as starters. Do you have any other observations on this position?

Mr. SHAD. I think that if anyone were to review what happens at the Commission they could not predict what parties the Commissioners are from. I think it's not a political institution. It's an independent regulatory institution.

Senator SARBANES. Do you regard yourself as part of the executive branch of the Government?

Mr. SHAD. No.

Senator SARBANES. What do you regard yourself as?

Mr. SHAD. I wouldn't be here if I didn't share many of the views that were expressed by the President in the course of his campaign. I believe that this Nation has suffered seriously because of disincentives to save and invest and that we need to dramatically improve our rate of capital formation which has plummeted from among the highest to near the lowest in the industrialized free world. And so I share philosophically, I believe, the views—and not just those of the President; there are plenty of people on both sides of the aisle who believe that we've got to do much more to improve our rate of capital formation in the United States.

Senator SARBANES. I'm not quarreling with that and that's not really the point I'm trying to get at. I'm really trying to get at a very simple, almost textbook point. As Chairman of the SEC, how do you regard the SEC in terms of its position in the Government? Are you a part of the executive branch?

Mr. SHAD. No.

Senator SARBANES. What are you, then?

Mr. SHAD. We're an independent regulatory agency accountable to Congress.

Senator SARBANES. All right.

Mr. SHAD. We were created to help Congress or to help implement the laws that Congress passed.

Senator SARBANES. And your pamphlet, in fact, says the SEC is an independent, bipartisan, quasi-judicial agency of the U.S. Government.

I'm interested in the process by which you make up your budget and the process by which the requests that are before us were arrived at.

PERSONNEL NEEDS

Mr. SHAD. The Division Directors prepare the first analysis in terms of what they view their personnel needs. It's not in terms of dollars but personnel for the period involved. That is put together by the Executive Director, George Kundahl, who is seated to my right. I review it at that preliminary stage with him. It's submitted to OMB for their reaction. They have consistently proposed levels of personnel that they felt were adequate, and taking into account the national situation, the size of the Federal deficit and the efforts to reduce it, and that's given back to us. In this past year for 1984, I appealed for more than OMB provided. The net result was that the appeal went to the White House, and we did receive a dollar increase, but not a personnel increase in the prescribed level that OMB recommended.

We then have meetings within the Commission based on a personnel level—and it's an open and candid exchange between the Division Directors as well as with me and with the executive director and anyone else in the room—and it's sort of part of what's going on is the relative needs of the division within the size pie we have. So if you only are allowed *x* number of people, each Division makes a strong case for its needs and there's a determination then.

The way it's been historically handled at the Commission I'm told is that the Chairman then makes the final decisions as to how the pie is divided up among the Divisions. What's been going on in the term that I've been there is that very little percentage changes have occurred within the Divisions. This year is of course a flat year in personnel. My conclusion has always been to cut enforcement the least, because I believe that it gives viability and visibility and credibility to all other operations at the Commission. It's one of those essential areas, but because it's by far the largest program, we've even had to reduce the enforcement side. Another key area is the full disclosure program. We had 65,000 filings last year. They're not all reviewed by any means. That's the responsibility of the Corporation Finance Division. They've got a huge workload and I said before you arrived that they are doing an outstanding job of upgrading the productivity of their reviews through the use of computers and paperwork reduction and a variety of other areas. That's how it's arrived at, sir.

Senator SARBANES. All right. That's a helpful overview. Let me take it step by step. When the Division Directors are asked to prepare and pull together the personnel needs within their division, this occurs, I take it, at the very outset of the budget process within the Commission?

Mr. SHAD. Yes.

Senator SARBANES. What guidelines are they given?

Mr. **Shad**. They are provided guidelines, again, that are initially provided by OMB.

Senator **Sarbanes**. I see. Now what was the nature of the OMB guidelines that were provided?

Mr. **Kundahl**. I don't think I have here the initial OMB guidelines, but I can tell you that the budget we requested of OMB——

Senator **Sarbanes**. Would you furnish those to the committee for inclusion in the record?

Mr. **Kundahl**. Yes, but I can tell you the budget we submitted to OMB exceeded the guidelines they gave us considerably, I believe by a hundred and some people.

Senator **Sarbanes**. Do you have the numbers in terms of positions that we're talking about?

Mr. **Kundahl**. Yes. I think I can tell you how many we asked OMB for.

Senator **Sarbanes**. What was that?

Mr. **Kundahl**. We asked them for 1,920 staff years.

Senator **Sarbanes**. And they've given you a benchmark of what?

Mr. **Kundahl**. 1,795 staff years.

Senator **Sarbanes**. Now how many positions do you have at the moment?

Mr. **Kundahl**. I believe the onboard strength today is 1,910.

Senator **Sarbanes**. Is that actual employees or positions?

Mr. **Kundahl**. Those are actual people onboard.

Senator **Sarbanes**. What about positions authorized?

Mr. **Kundahl**. Positions funded this year are 1,892, authorized, I believe is 2,021.

Senator **Sarbanes**. So you had 2,021 authorized and OMB gave you a benchmark of 1,795, is that correct?

Mr. **Kundahl**. That's correct, but we're talking about two kinds of positions. The 2,021 are authorized but not funded. They weren't funded by the Congress for 1983; 1,795 is the actual funded staff years for 1984.

Senator **Sarbanes**. Is that what OMB gave you or did they give you an authorized figure?

Mr. **Kundahl**. Well, they give us both.

Senator **Sarbanes**. What was the authorized level?

Mr. **Kundahl**. The authorized level that corresponds to 1,795 is 1,896.

Senator **Sarbanes**. What figure was it that you gave them on the authorized in response to this first submission subsequent to the division director action?

Mr. **Kundahl**. I believe we asked them for 2,021. We asked to continue the 1983 authorized level into 1984.

Senator **Sarbanes**. So you had an authorized level of 2,021 and the OMB prior to the division directors beginning their exercise gave you the figure of 1,896?

Mr. **Kundahl**. No. The OMB ceiling comes out in a letter during the summer before we begin these deliberations, and I didn't bring that letter with me and I can't recall what it said. It usually is not stated in terms of positions however. It's usually stated in terms of dollars, and it says do not come in with a budget that exceeds this dollar amount; and it's that dollar amount that I said earlier that we had exceeded in our request to OMB.

Senator **Sarbanes**. As I understood it earlier, you gave me two figures from OMB, 1,896 and 1,795.

Mr. **Kundahl**. That's right. That's what they came out with.

Senator **Sarbanes**. The first figure was the authorization figure to compare with the 2,021. The second figure was the funded figure to compare with the 1,920. Is that not correct?

Mr. **Kundahl**. No, that's not correct. In the President's budget now pending before the Congress, we show 1,896 positions in 1984, and we show, of that 1,896, 1,795 being funded. That was the final decision of OMB. After we submitted our budget, they gave us an initial passback, we appealed, and after all of that, this is where they came out.

Senator **Sarbanes**. You know, we were up late and it's relatively early and I really have a very simple mind in any event, so I have to take this step by step. I want to make very sure I understand this budget process.

The OMB gave you a mark which the division directors were given when they began their deliberations. In other words, the division directors weren't sent into a room and told, "Now you figure out what you need in order to do your responsibilities" as the criterion. They had that, I take it, as one criterion, but had in addition the OMB mark as a criterion—I ask you, Mr. Chairman, is that correct?

Mr. **Kundahl**. We didn't give them a specific level to come in with. We pointed out that it was a tight budget environment and we told them what we were expecting to get in 1983, because at that point the 1983 appropriation had not been enacted. It still hasn't been enacted, but we have a continuing resolution. We said, starting from this proposed 1983 level, what do you project your needs to be for 1984. But we did not give each of the division directors a level and say, "Don't exceed this level."

Senator **Sarbanes**. All right. So they came in with 2,021, is that right, for authorization?

Mr. **Kundahl**. 2,021 are the number of positions that Congress authorized for us for 1983.

Senator **Sarbanes**. And that's what they thought should be authorized for 1984?

Mr. **Kundahl**. No. The Division Directors came back with a different level. I don't think I have with me the level they came back with, but it did not add up to 2,021, and the reason it did not add up to 2,021 was at the time we were going through this exercise we were projected to take a staff reduction in 1983. So we were starting from a low base. And the budget we eventually submitted to OMB exceeded the eight parts or the eight programs that were given to us in August by the eight division directors.

Senator **Sarbanes**. Then you submitted your request to OMB, is that correct?

Mr. **Kundahl**. That's correct.

Senator **Sarbanes**. For their reaction, according to the Chairman. And what was their reaction?

Mr. **Kundahl**. They came back to us in mid-November with a proposal or a recommendation that we be funded for $88,800,000 and 1,795 staff years.

Senator **Sarbanes**. And did they have any recommendation as to the authorization you should be seeking?

Mr. **Kundahl**. No. We do not have to clear our authorization through the Office of Management and Budget. We are required by the Budget and Accounting Act of 1921 to submit our appropriation request to them, but not requests for substantive legislation, which is what an authorization is considered.

Senator **Sarbanes**. Does that mean that the authorization request that you've submitted is based on your judgment of the needs of the agency solely and not related to restraints being imposed upon you by OMB?

Mr. **Kundahl**. Basically, yes, sir.

Mr. **Shad**. That's one of the reasons there's an $8-million difference between the requested authorization and the appropriation proposal.

Senator **Sarbanes**. So you're taking the view then that your reduction in the authorization request is not related in any way to the OMB treatment of your agency or budget?

Mr. **Kundahl**. Not completely. In 1985 and 1986, that's correct. The way we derived the 1984 number was to begin with the pending appropriation level and to add two factors, to add an amount of money to pay for a projected four percent pay raise in October of this year; and second, to take a very rough estimate of the effect of Glass-Steagall amendments now pending before the Congress on our resources and to include an amount to cover that should those amendments be enacted. And it was adding these two increments to the President's budget that came up with the $99,800,000.

Senator **Sarbanes**. What is the distinction you make between 1984 and 1985 and 1986?

Mr. **Kundahl**. In 1984 we began with the President's budget and added Glass-Steagall and a pay raise in October. In 1985 and 1986 we also took into account changes in the market, possible increases in workload, and developed those estimates and included them in each year, as well amounts for pay raises in succeeding years.

Senator **Sarbanes**. Where does the Congress get from the Commission the Commission's best judgment on what it needs to do the job before restraint or constraint has been placed upon the Commission by the OMB?

Mr. **Kundahl**. The document we submitted to the Congress and to Vice President Bush on the 2d of February gave you a budget authorization request which——

Mr. **Shad**. It was also submitted to speaker O'Neill.

Mr. **Kundahl**. We gave you this unconstrained statement of our resource needs for the next 3 years. I might add that the Division Directors made input into these levels for 1985 and 1986 and we did not cut those at all. We passed them along to you as they were submitted to us.

PURSUE IN DEPTH

Senator **Sarbanes**. I see Senator Proxmire is here and the chairman wants to move on. I'm going to come back to this. I want to pursue in some depth this morning the fact that the Commission is an independent, quasi-judicial agency of the U.S, Government and owes the Congress, as well as the executive and the country, its independent judgment on its need for resources. The Budget Act requires your budget to move through the OMB, but you're not a line department of the Federal Government and you're not subject to the same position as a line department of the Federal Government.

Mr. **KUNDAHL**. That's true, but in the case of other independent regulatory agencies such as the CFTC, Congress has specifically directed them to submit an uncut version of their budget to the Congress at the same time it's submitted to OMB. You've never directed us to do that.

Senator **D'AMATO**. Do you think that's a good suggestion? I do. I wouldn't take anything that comes out of OMB. It's incredible.

Senator **SARBANES**. Are you asking for that now? That's not a bad idea.

Senator **D'AMATO**. That's a very good idea.

Mr. **SHAD**. We're not asking for it.

Senator **D'AMATO**. You're not asking for it? Well, I think you may need it.

Mr. **SHAD**. We would welcome any ——

Senator **D'AMATO**. I think Senator Proxmire would think you might need that. What do you think, Bill?

Senator **PROXMIRE**. I'm sorry. I missed that.

Senator **D'AMATO**. The Commission requested that they be authorized to submit their original unjust budget to congress concurrent with their submission to OMB.

Senator **PROXMIRE**. I think that's particularly sensible, Mr. Chairman, in view of the fact that most of their cost are offset by revenues from fees.

Senator **SARBANES**. Ninety-four percent, isn't that right, Mr. Chairman?

Mr. **SHAD**. It was for 1982.

Senator **PROXMIRE**. This isn't the usual kind of problem we have with a great effect on the deficit. They can control their own fees on that basis, and for that reason particularly I think it's a good idea.

Senator **SARBANES**. On this very point, Mr. Chairman, I understand that in the past the Commission's OMB submission has been made readily available to the GAO. Is that correct?

Mr. **SHAD**. As far as I know, yes.

Mr. **KUNDAHL**. Well, OMB does place some restrictions on ——

Senator **SARBANES**. I further understand from GAO that this year the SEC would not release its submission and that GAO had some difficulty gaining access to it. My question is, why did the Commission change its practice in providing the OMB submission to the GAO?

Mr. **KUNDAHL**. Senator Sarbanes, we take our guidance on this from the Office of Management and Budget. When we checked with them we were told that if a Member of Congress requests a copy of Your submission, we should give it to them. In two cases in the House of Representatives, from Congressman Wirth and Congressman Rinaldo, we received letters and we gave them a copy of our submission. While the budget is still pending before the Congress OMB told us not to give it to GAO or to the congressional staff unless we had a letter from a Member of the Congress. So if you gave us a letter we would be glad to do that.

Senator **Sarbanes**. Mr. Chairman, I think we should give them such a letter.

Senator **D'Amato**. All right. We're asking you for that now. Do we have any problem with that?

Mr. **Shad**. I have no problem with that.

OBSERVATION

Senator **D'Amato**. Before I turn this over to Senator Proxmire, let me just make an observation.

No. 1, I think that's a wonderful suggestion that came from the SEC that they be given the same latitude regarding submission of their budget that the CFTC has and I will suggest that to the full committee in the form of a technical amendment. I think such an amendment would probably sail right through.

No. 2, I think we would be doing ourselves and the Commission a disservice if we didn't recognize that the collection of fees has increased rather dramatically in the past and factor this in to any decisions on SEC staff levels. I don't think it's fair to the Commission that the efficiency of anything in terms of collections in terms of number of cases, from all measurable manners that we can perceive, be allowed to be impaired. However we do encourage productivity gains and we do commend the Commission for their recent gains.

But there is, without doubt, a great fear by members of this committee that there may be more restraints being built in than are necessary and that may in the future impair that efficiency. I, for one, share that feeling. I've seen the way that operation is run. It's run by nothing more than saying, "Let see, if we get a couple dollars here and a few dollars there," and that's the amount. In many cases there's little consideration given—they defer money we allocate; they make judgments that don't save taxpayers' money. You talk about tax-exempt bonds. They were ready to jump on it and hold it back even when we said use them. So I have very little faith in them.

Mr. **Shad**. Well, Senator, I would like to amplify.

Senator **D'Amato**. No, you can't respond to that. You can amplify later. This is my time. I've given you a lot of time. I've given all members of the Committee time. This is my time.

RESOLVE AT ANOTHER HEARING

Now I also think that if we're going to resolve this in the manner in which we can all feel comfortable we're going to have to have another hearing in regard to this matter. I'm going to ask that the other four Commissioners be here so that we can resolve this. This is too important a matter and you've worked too hard and staff has worked too hard and members of this Congress and this body has worked too hard. I'm going to see to it that the high standards that we have—I believe we do have them—are maintained and this is why I was determined to get at the bottom of the mess concerning the Reed investigation. Certainly that mess isn't at the Commission's doorstep. It may be someplace else. We're not going to jeopardize the quality of the SEC at this point in time. So I'm going, in conference with other members of this committee to pick a date and bring in the four Commissioners and we will lay it out on the table and resolve it openly, quickly, fairly, without assessing blame or responsibility, and come to a conclusion that all the members by consensus of this committee can sustain. Because I want to tell you something. For the lack of $3 or $4 million, I just think we do a terrible disservice to a body that's just too important to the integrity of the industry. The industry doesn't mind tight, tough enforcement. They want it to be fair, tight ——

Senator SARBANES. Efficient.

Senator D'AMATO. All those things.

Mr. SHAD. And they're getting it.

Senator D'AMATO. I understand, but for $3 or $4 million in terms of the difference, I just think we do ourselves a terrible disservice.

Senator SARBANES. Mr. Chairman, I want to commend you for that. In fact, later in the morning I was going to make that suggestion to you, although we've not actually discussed it. I want to say that we both have been proceeding independently down the same path. I do think it's important, given that the other Commissioners have taken this an open position with respect to the adequacy of the budget, that we hear from them as well in an effort to explore this matter fully.

SHARE CHAIRMAN'S VIEW

I share the chairman's view that an effective, well-staffed SEC is a service to the investor and to the investment industry.

Mr. SHAD. I agree as well.

Senator SARBANES. We want to make sure that's the case and we particularly want to make sure—at least I do— that as an independent, quasi-judicial agency, bipartisan, as you said, apolitical, and I think that's certainly been true of the Commission—constraints are not being placed upon you by OMB in the context of other problems to which you're hardly contributing since you're funding 94 percent of your activities.

Mr. SHAD. You know, that number keeps getting mentioned. It requires qualification.

Senator D'AMATO. But that doesn't go to the SEC.

BUDGET GENERALLY FUNDED

Senator SARBANES. Even if it's lower, there's an argument, of course, that your budget to some extent should be generally funded since you provide a general service. The industry makes that point and says it should be 100-percent funded in any event. It's been brought up significantly. I was involved in that issue a few years back. The percentage was much lower. I forget what the figure was, but in fact at that time your special assistant John Daniels was on the staff of this committee as we worked on the problem of trying to get the SEC to reexamine its fee schedule and make adjustments in such a way that fees would provide a greater part of its budget.

Senator D'AMATO. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

I want to congratulate first on the idea of calling another hearing so that we can get the views of the other Commissioners in view of the fact that they have indicated that the budget would make it extremely difficult for them to do their job.

Mr. Shad, because of the concerns expressed, how about a 1-year authorization so we can keep a very close eye on this in view of the fact that both the Commissioners and the chairman and ranking member of the subcommittee have this concern, which I share and I think other members of the committee share too, so we can make sure that this is fully and adequately funded during this period?

Mr. SHAD. It does require considerable staff time to go through an authorization hearing. We are now on a 3-year authorization basis and I would strongly recommend continuing that practice.

Senator PROXMIRE. Well, we can see the benefits of that here today. This hearing I think—unfortunately, I was late, but even in the short time I've been here I can see that it's been an extremely productive and useful exercise for us and I think for you and the Commission.

Mr. SHAD. Well, I think the other Commissioners would join me in recommending——

Senator PROXMIRE. Recommending a 3-year rather than 1-year?

Mr. SHAD. Yes. Let me also say something else. I hope that this procedure—and I think that Congress has every right to do whatever it wants and for us to be completely supportive and cooperative, but I know of no better way to destroy lines of authority than to have the staff—as was done in the House—have the staff providing their submissions directly to the committee and the Commissioners providing their views. I will accurately—and I think it's been true consistently—where it's an area that I'm required or should provide the views of the staff or the Commission, I try to report that very responsibly. So what I see happening by what's going on now—and that's your decision—but I think what you're doing is you're going to have the staff reporting to your staff and the——

Senator D'AMATO. That's not the case. Excuse me, Mr. Commissioner and Senator Proxmire. That's absolutely not the intent of this committee. Nobody suggested that. I wouldn't countenance that. But we certainly think that we shouldn't be defensive in this matter, that asking the Commissioners to come in—and I would also suggest to you before I finish my thought on that—that you sit down with the other Commissioners and see what kind of consensus can be arrived at in terms of what they initially recommended. Nobody is looking to come in and interfere with your lines of responsibility or to go to the staff with respect to this, but certainly there's no way of getting around the fact that there is an indication by four of the Commissioners that they feel that this level may be injurious to the quality of service rendered by the Commission and the responsibility it has in discharging its obligations.

Now let's not get into a discussion about whether we're going to demean or cut your authority, et cetera. That's not the case and I don't want to hear it.

Now, Senator Proxmire, excuse me.

Senator SARBANES. Mr. Chairman, can I just say something?

Senator D'AMATO. I just felt that had to be said.

Senator PROXMIRE. I'm happy to yield to the Senator from Maryland.

SUPPORTIVE OF SEC

Senator **Sarbanes**. Chairman Shad, I want to say this subcommittee has had a consistent record of being very supportive of the SEC and trying to make sure that you have the resources with which to do the job. We've felt over the years that the agency has been of very high quality—it stands out in that regard within the Government structure. I think the industry generally feels that, although they have difficulty from time to time, and certainly the Chairman and I and others here are really concerned with maintaining the strength and quality of the Commission, and particularly concerned—I guess in my instance at least—that OMB and others are not imposing directives upon you that are going to undermine or weaken the agency.

Senator **Proxmire**. May I ask Mr. Shad, on February 1, almost 2 months ago, 12 of us on the committee wrote to you concerning the SEC study on tender offers.

Mr. **Shad**. Yes, sir.

Senator **Proxmire**. We asked that the SEC address itself to a number of specific issues in the letter.

Mr. **Shad**. Yes.

Senator **Proxmire**. Could we have your assurance that the SEC and its Advisory Committee will address itself to every question set forth in that letter? We got some kind of response but it seems to me it wasn't responsive to each of the specific questions.

Mr. **Shad**. Well, the way the committee has been structured is that we've got I think an incredible group of outstanding individuals that are thoroughly knowledgeable on the full area of tender offers. Some of them have been tender offer targets, some of them bidders. We have top economists, arbitrageurs, investment and commercial bankers, the head of one of the largest accounting firms, and so on. We have asked them to come up with their agenda and specifically to address the questions in your letter.

Senator **Proxmire**. So they're going to do that. Can you give us some idea when?

Mr. **Shad**. We have asked for the final report by July 8 so that we could provide it to you by July 31, as requested.

Senator **Proxmire**. That's fine. Now the composition of the SEC Advisory Committee on Tender Offers has been called a "class reunion" by the Wall Street Journal. It appears to me to be highly industry oriented with no representation of the State commissions.

In view of the fact that State jurisdictions have made the request under the tender offer laws, shouldn't the State commissioners—I understand Mr. Mahaley of New York, for example, would be an excellent appointment—shouldn't a State commissioner be appointed a member to represent the investor point of view? Without such representation, the committee does seem to be and it has been criticized to be too industry oriented.

Mr. **Shad**. Well, there are no regulators on there. The SEC is not represented either, nor is the FTC, which expressed interest in this matter. They're all invited to have people attend the Advisory Committee meetings. They're all open meetings. But no regulators are on it. The purpose is for the committee to review the full area in the best interest of all shareholders, those of target companies and bidders as well as tender offeror companies, and propose improvements for the benefit of all shareholders in the regulations and in the law. Then we will transmit those recommendations to you.

STRONGER INVESTORS REPRESENTED

Senator **Proxmire**. Well, why wouldn't it make sense to have some stronger investor representation?

Mr. **Shad**. The chairman of the committee is Dean LeBaron, who's the head of Batterymarch, which manages $8 billion of equity securities for individuals. They have many institutional clients, pension funds and others, but those are ultimately for the benefit of individuals. That's the chairman. The senior vice president of Morgan Guaranty is on the committee. They are the largest of any of the banks that manage pension funds for the benefit of individuals.

Senator **Proxmire**. Well, they seem to be primarily big operations. I've got great respect for Morgan Guaranty. I used to work for them years ago. But it seems to me that representing the rank and file investors, as the State commissioners do, that it would be a better view of it. I see what you're trying to get at, but there does seem to be a reasonable degree of criticism on the art of observers like the Wall Street Journal.

Mr. **Shad**. Well, you know, I've never found that anything we do is——

Senator **Proxmire**. What was your reaction when they called it a class reunion?

Mr. **Shad**. Did that relate to the Bendix-Martin-Marietta? There's no basis for a class reunion statement.

Senator **Proxmire**. It was related to that, sure.

Mr. **Shad**. Well, yes, the chairman of the board, Ed Hennessy, of Allied, is a member and he's spoken out very directly in terms of being critical of the present system in terms of the best interests of investors. There's also the two top lawyers in the country on that, Joe Flom and Martin Lipton, who were on opposite sides of the Martin-Marietta, as they are on almost every major tender offer.

So, yes, there are a lot of top people that are the most outstanding authorities in the country on this subject.

Senator **Proxmire**. Let me ask you about something else. Here's what the Securities Industry Association says about your shelf-life rule. SIA proposes balancing the needs of companies who issue securities quickly against the needs of investors to have adequate information and time to make reasonable investment decisions. The pendulum has swung too far to the side of issuers." That's the SIA.

INVESTORS PROTECTION

It seems that the trade association, which is the SIA, is ahead of the SEC on investor protection, as incredible as that may seem. What's your comment?

Mr. **Shad**. I think that there are responsible sources who are concerned over the accelerated time schedules now available to issuers in terms of ability to due diligence, but it's not just the shelf rule. Even going back to form S-16 and certainly the S-3 for major issuers, there have been accelerated time schedules. If you want me to I can tell you what's going on in terms of the actual filings under the shelf rule, because I think it would relieve some of the concerns.

Senator **PROXMIRE**. Well, let me quote from the SIA statement:

> The addition of selected financial data in the management and analysis that bear upon prospectus that's going to be used, SIA believes this will aid investors in their investment decisions. Current rules incorporate this material by reference to filings already made to the SEC. Experience has shown that the individual investor seldom if ever requests this information and, even if requested, the material would arrive too late to assist in the investment decision.

Now that's a pretty damaging statement it seems to me and indicates that the SEC rules appear from the SIA to be stacked against the investors.

Mr. **SHAD**. Well, I think the weakness in that statement is the fact that shareholders seldom if ever request it. So it doesn't show a high level of shareholder interest or concern about that information, unfortunately.

Senator **PROXMIRE**. Well, it's just too complicated.

Mr. **SHAD**. Well, that's what we've been trying to improve by simplifying, and the information is in the marketplace, reflected in the efficient market system we have. To publish yesterday's newspaper is not the most productive use of legal and accounting and management time, and that's what's been going on in this area. We have ineffect been publishing yesterday's newspaper in prospectuses over and over again, duplicatively.

Senator **PROXMIRE**. Well, let me ask you one more question with respect to SIA. They also charge.

> SIA also repeats in its submission its earlier charge that the SEC did not fulfill its obligation under the regulatory flexibility to determine the effect of the rule OM-5 on smaller issuers and smaller broker-dealers.

Again, that's a pretty serious charge by the SIA and what's your response? What's your judgment on the effect on the shelf-life rule on smaller issuers and smaller broker-dealers?

Mr. **SHAD**. Is Dan Goelzer here? Dan, as I recall, we did have a memorandum on that.

Mr. **GOELZER**. That's my recollection also. I think based on the research of our economics unit and the Divisions of Corporation Finance and Market Regulation there was a factual determination that there would not be an effect on a significant number of small entities. We have a definition in our rule of small broker-dealers and I think research showed that few, if any, of them would be involved in the kinds of registrations that would be subject to the shelf rule. Of course, the shelf rule itself only applies to very large issuers.

Senator **PROXMIRE**. Well, Mr. Chairman, I think this is something maybe the committee would want to follow up on because it does seem to lead in the direction of concentration of resources and it does indicate that small operators, small issuers and smaller broker-dealers are affected. I share the concern of the chairman, too.

Senator **D'AMATO**. I think we could probably go into this later on in the session.

Senator Sarbanes.

Senator SARBANES. Chairman Shad, in your budget authorization request, you indicate with respect to the investment companies that your resources are sufficient with respect to the 5½ year cycle, is that correct?

Mr. SHAD. Yes.

Senator SARBANES. Now I understand that of the inspections, about two-thirds of them turn up deficiencies or violations that require remedial action.

Mr. SHAD. A significant number. I don't recall the number two-thirds, but a significant number. Most of those are very minor infractions, but it does keep the investment companies aware of the presence of the Commission and that they are being carefully reviewed.

Senator SARBANES. Would you think further resources would be in order to permit inspection in a more frequent cycle?

ADVISERS SCREENED

Mr. SHAD. The investment advisers are now being screened on computers which permits a quick identification of areas of concern and those that require more frequent review. The investment companies are not yet computerized. That's under consideration in terms of the method and the cost of doing it, but I believe that there is the prospect of significantly improving efficiency of investment company reviews through greater use of present technology. So I wouldn't draw that conclusion yet. Let me also add that while a significant number have come up with infractions of various sorts, the problems with the industry have been insignificant, zero. Even during false rumors and relatively rare instances of drastic runs on money market funds and the recent substantial outflows related to the creation of new bank money market acount they have been able to accommodate redemption requests without incident.

Senator SARBANES. I understand you proposed for comment a release regarding an SRO for the investment companies, is that correct?

Mr. SHAD. Yes, sir.

Senator SARBANES. I take it your idea is that you're going to shift the regulation away from the Commission and into a self-regulatory mechanism?

ROUTINE INSPECTIONS

Mr. SHAD. Routine inspections, under the oversight of the Investment Management Division.

Senator SARBANES. Do you have any estimates on the cost factors involved?

Mr. SHAD. $4.5 million is a number that comes to mind.

Senator SARBANES. For industry?

Mr. SHAD. No, the relief to the Commission in terms of staff requirements.

Senator SARBANES. What's it going to cost the industry?

Mr. SHAD. It's going to cost more than that.

Senator SARBANES. Well, what kind of savings is that?

Mr. SHAD. $4.5 million.

Senator **Sarbanes**. For you, but not for somebody else. This is an interesting point. I'm fascinated by this because it's certainly Mr. Stockman's approach. He figures that if he gets the cost out of the budget he has a saving, even though in order to carry out the activity, leaving aside for the moment whether it would be carried out as well in qualitative terms, the cost would be much greater.

My understanding in this area, for example, is that the cost to the industry would exceed markedly what it would cost the Commission itself to do it more effectively. If that's the case, I don't see that any savings in a social sense is realized. Of course your budget is a little smaller, but you have simply accomplished that by pushing the responsibility off onto someone else who has to incur much larger costs in order to meet the responsibility.

COSTS INVOLVED

Mr. **Shad**. They would be paying for the costs that are involved. In other words, you're shifting from the general category of the Commission to the specific segment of the economy involved to bear the expense.

Senator **Sarbanes**. Wouldn't it be better, if you can do it much cheaper, to put a fee on them and raise the money, rather than put the burden on them and force them to spend more than you would have to spend in order to do the job?

MANAGEMENT STANDARDS

Mr. **Shad**. There are some who feel that they would do a better job in some areas, such as management standards and ethics and standards of conduct and so forth. There's been a lot of encouragement by Congress, and it's in the Securities Exchange Act to do more with self-regulatory organizations. In other words, having the industries police themselves, subject to Commission oversight.

Senator **Sarbanes**. I understand the estimates are that for another $3.3 million you could put the companies on a 2-year cycle. There are estimates that if you set up an SRO it would cost them about $5.6 plus million, and conceivably up to another million to the SEC to oversee the work. So that, in effect, you would almost double the cost by pushing it out on an SRO.

Mr. **Shad**. The question is whether the inspections and the process would be better than they are now.

Senator **Sarbanes**. I'm willing to listen to that, but earlier you were making a point that you would save $4.5 million in budget saving, I don't regard it as a budget saving if you impose an even greater burden upon somebody else.

COMMITTEE ON TENDER OFFERS

I wanted to address this question that Senator Proxmire touched on. How was the Advisory Committee on Tender Offers selected?

Mr. **Shad**. By suggestions and recommendations from other Commissioners and the staff, and then some of the key people that were contacted before they were invited actually to be members. I think most of them were identified by reputation. They're just so well known as being the top people in their field.

Senator **Sarbanes**. Was it made as a Commission decision or was it the Chairman's, your decision?

Mr. **Shad**. The Chairman's decision, as is provided in the Commission's standing practice for the Chairman to appoint such committees.

Senator **Sarbanes**. Could you just go through it very quickly and note why these people were picked? There are 15 of them as I understand it.

Mr. **Shad**. There are 16. I don't have the list in front of me.

Senator **Sarbanes**. I think maybe you could submit that.

Mr. **Shad**. I can do it from memory if you would like me to do it.

There are three attorneys, Joe Flom, Marty Lipton, and Irwin Schneiderman. I believe that most would acknowledge that they have been involved in by far the largest number of major mergers and acquisitions and tender offers. They're highly regarded in the legal profession.

There are two so-called bidders, the chief executive officers of companies that have been involved in making tender offers. That would be Ed Hennessy and Mike Dingman. Ed Hennessy of Allied Corp. and Mike Dingman—he took over Pullman and ended up doing a friendly upstream merger into the Signal Companies. The name of his company is Wheelabrator-Fry.

There are two representatives of companies that have been targets or the subject of possible acquisition efforts by other companies. They would be Alan Gruber of Orion Capital, and Jensen who's now a consultant who was formerly the head of G.K. Technology and was his own successful defender of a takeover.

There are two economists—there are two academics I should say, Mr. Easterbrook and Mr. Jarrell, who have written extensively on the subject, one from an economic point of view and the other from a legal point of view.

Senator **Sarbanes**. They're both from the University of Chicago?

Mr. **Shad**. Yes, they are.

There's the chief executive officer of Ernst & Whinney, the accounting firm. There are two arbitrageurs which are a fundamental factor in tender offers, Mr. Tarr and Mr. Rubin.

There are two investment bankers, Mr. Wasserstein and Mr. Greenhill, Mr. Wasserstein from First Boston, Mr. Greenhill from Morgan Stanley, who also have been involved in major tender offers.

There's Mr. Spurdle, who's the senior vice president of the Morgan Guaranty. North America is his domain, and his responsibilities on the committee relate to both the financing of tender offers since Morgan Guaranty has financed some of them, as well as to the interest of the billions of dollars of equity money managed by the Morgan Guaranty for the benefit of individual investors.

As I mentioned earlier, Dean LeBaron, who's the head of Batterymarch, a management group which manages $9 billion of equity capital for the benefit of individual investors was unanimously approved as the chairman of the task force. And I'm not sure whom I've left out.

Senator **Sarbanes**. Did you mention Greenhill?

Mr. **Shad**. Yes, Greenhill and also Wasserstein are the two investment bankers.

Senator **Sarbanes**. My reaction to this committee is a little bit like Senator Proxmire's—not a little bit, quite a bit like Senator Proxmire's. It's all the interested parties, even though they're on opposite sides. But who's bringing a broader perspective to the committee of a general public interest concern about the impact of tender offers? You've got representatives of the companies that try to do this and you've got representatives of the companies that try to fend it off, and you've got the lawyers who are on one side and the lawyers on the other. You've got the bankers who have to underwrite it. You've got the accountants.

STATE SECURITIES

But there's no one from the State securities people. I don't necessarily think someone from the SEC ought to be on it. It's an advisory committee to you and I assume its recommendations will be carefully vetted by the Commission in terms of how to move forward with it. Shouldn't there also be some broader membership, some broader perspective here, and particularly some membership that hasn't been playing this game on either one side or the other, but is able to sort of look at it and think about the extent to which a broader public interest is involved?

Mr. **Shad**. That's true of the academics and the chairman of the committee.

Senator **Proxmire**. Would the Senator from Maryland yield on that?

Senator **Sarbanes**. Yes.

Senator **Proxmire**. I couldn't agree with the Senator from Maryland more. I appreciate the notion that you've got these bright people, intimately involved, the experts, and you should have experts, no question about it, and you sure have them here in spades. But there does seem to be a concentration. The only academic you've got both come from the University of Chicago, that great liberal bastion of a free market.

Mr. **Shad**. They're two of the top authorities in the country.

Senator **Proxmire**. But when you look down the list you've got Morgan Stanley, Ernst & Whinney, Allied Corp., Batterymarch, Martin Lipton—you know, all these fellows are the biggest and best and brightest in the business. It seems to me that the position that Senator Sarbanes and I take is that the public interest, the people who are concerned if you have a takeover and the industry moves out of the State or moves out of the city and leaves it—leaves Milwaukee or Baltimore in bad shape—there's no representation of that kind of view.

Senator **Sarbanes**. What about Bob Eckhardt, for example, just to throw out a name, the former Congressman, actively involved with SEC matters, a man of strong independent judgment? It seems to me you ought to get something of a mix on this committee so that its recommendations are not simply being made by that small family involved very directly and very financially in this activity, even though on competing sides.

Mr. **Shad**. May I come back to you on that? Is that the view of the subcommittee? Are you proposing Bob Eckhardt?

Senator **D'Amato**. At the risk of maybe attempting to curtail this area of exploration, I would think that it would be more proper—and I do not disagree in any way with the contentions of my colleagues that we certainly should look at the makeup and the composition of the committee. I think they're suggesting a broader base. I do believe there's a strong consensus that the Congress should at the very least examine what's taking place in the industry and some of the things I absolutely feel are wrong and they're not in the public interest, one eating the other, tying up vast quantities of capital, the golden parachutes which may be a great thing to get the public aroused but there are some legitimate questions.

Senator **Proxmire**. If the chairman would yield, I do think it would help a lot if we did have State commissioners, people like Mr. Eckhardt or people who we know who are expert.

Mr. **Shad**. What about other regulators as well?

Senator **Sarbanes**. What?

Mr. **Shad**. The purpose is to review the State and Federal laws that govern this area. Do you want—you know the committee will make recommendations and they are going to be passed on to Congress and you will have hearings if you wish to.

STATE REGULATORS

Senator **Proxmire**. I'm not suggesting you dominate it with State regulators, but one State regulator could give that viewpoint and persons like Eckhardt would be a real breath of fresh air and would help a lot.

Mr. **Shad**. What about the FTC? The FTC is very concerned about the antitrust questions raised in this area. Should they be also represented? The purpose was specifically not to include regulators.

Senator **Sarbanes**. There's a difference between the State regulators and the Federal regulators. I agree with not putting an SEC person on it. I think the FTC is more worth thinking about. But it seems to me there ought to be a couple people—I just mentioned Eckhardt because he came to mind—who clearly have some knowledge but also some independence and don't come from one camp or the other. I think it would also help to have one or two of the more eminent State people who are not going to be as closely involved once the recommendations come in and the process takes place only here in the Congress.

Mr. **Shad**. All the meetings of the committee are open to the public, and if you wanted they could be specifically invited to come.

DIVERSITY OF COMMITTEE

Senator **D'Amato**. Mr. Chairman, I think that the Senators are indicating to you that it may possibly add to the diversity of the committee by including some of the kinds of people they've suggested. It might even diminish the outcry that it's all the old boys working together in the clubhouse and add to the credibility of the conclusions that the Commission or the committee eventually comes up with. So I take that in a constructive manner, not one to demean the work. Obviously when you get people of the caliber that you've brought together we're impressed. But to further enhance that work, it's being suggested that you possibly look toward some of the State people and some of the others who may be interested in this area and who are not directly related on a day-to-day basis with the transaction of tender offers.

Mr. SHAD. Would you suggest Mr. Latham, the head of NASSA?

Senator D'AMATO. I'm not going to suggest anybody and I don't think the Senators here are suggesting anybody. They've indicated to you the areas which you might consider—State regulators, for example, other people in the area, another academician other than two from Chicago—and so if you want to—staff can contact this staff—this is something I didn't want to suggest but I'll suggest it now and you can draw the lines of communication. I'm not attempting to trap you. I'm not going to start suggesting this person or that person or the other. I'm not going to get into that. Are there any other questions?

[No response.]

Senator D'AMATO. Do you have any other statements that you would like to make?

Mr. SHAD. No, thank you.

Senator D'AMATO. Well, I think it's obvious that the four other Commissioners should come and testify before this committee. I would hope that we could do it in such a way as not to disparage your efforts or your work on the Commission because I think that the Commission has done an outstanding job. I think reasonable people can share differences of opinion and certainly legitimate inquiry must rest at this committee when we have the statements by the Commissioners that they feel that additional funds are necessary so as not to impair the work or the efficiency of the SEC. We recognize that reasonable people, intelligent people, people coming from the same point of view, may have differences. It's our obligation to resolve that, so there will be another hearing at which time we will ask your fellow Commissioners to join with you so that we can review these matters.

NO CRITICISM

Senator PROXMIRE. If the chairman would yield, I would like to support the chairman in the argument that this is no way a criticism in any degree of the Commission in calling this additional hearing. We do think that the fact that the Commissioners have indicated their opinion which differs is sufficient for us to explore that a little bit.

But I'd like to say also, Mr. Chairman, that in a way you're kind of a victim of the fact that last night the Senate was in session until 2 o'clock in the morning and all three of us were there until 2 o'clock and we didn't get much sleep last night and so we are giving you kind of a vigorous workout this morning.

Senator D'AMATO. This committee stands in recess.

[Whereupon, at 11:20 a.m., the hearing was adjourned.]

ADDENDUM TO THE TESTIMONY OF JOHN S.R. SHAD, CHAIRMAN OF THE SEC BEFORE THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

MARCH 25, 1983

Chairman D'Amato and Members of the Subcommittee:

The SEC could of course do more with more people and money, but I believe the Commission can maintain its present levels of activity, despite a 6% personnel reduction in fiscal 1984, for the following specific reasons.

The SEC staff is doing an outstanding job at all levels of improving the Commission's productivity. Programs initiated by the Division Directors, the Executive Director and others last year and in progress, are expected to increase the Commission's fiscal 1984 productivity sufficiently to offset a 6% personnel reduction. These programs include the following.

I. Full Disclosure.

Approximately 500 to 1,000 additional companies are expected to become subject to the SEC's reporting requirements in fiscal 1984. However, this increase is expected to be more than offset by the following programs initiated by Director Lee Spencer, John Huber and other senior members of the Corporation Finance Division during the past year and in progress.

A. Computerization.

1. Over 70% of the 9,000 publicly-owned corporations are now being screened by computers which identify possible problem areas and tabulate key ratios and trends.

2. Over 700 additional companies will be programmed this fiscal year and most of the balance are expected to be added within 12 months.

3. Continuing improvements are being made in the selective review process through the use of micro-computers.

4. Conversion from a slow mini-computer to the Commission's upgraded mainframe computer and the establishment of a quality assurance program will enable the Office of Applications and Reports Services to process filings more rapidly and accurately than heretofore.

B. Paperwork Reduction.

During the past year, the Commission's paperwork has been dramatically reduced through:

1. Integration of corporations' registration and reporting requirements. Fifty to one hundred page prospectuses have been reduced to five to ten pages.
2. In response to the Small Business Investment Incentive Act of 1980, the exemption from registration of certain securities offerings (up to $5 million to other than the general public), as well as the simplification of private placement exemptions have further reduced the Commission's paperwork. Such financings are expected to exceed $25 billion this year.
3. Also in response to the Small Business Investment Incentive Act, the asset requirement of reporting companies was raised last year from $1 million to $3 million, which exempted about 500 companies from the SEC's reporting requirements.
4. The shelf registration rule permits companies to file a single registration statement covering securities they expect to sell from time to time, within two years. Over $40 billion of shelf offerings have been filed, since the rule was adopted on a temporary basis in May, 1982.

C. Staff Specialization.

Filings are now being reviewed by teams of industry and other specialists, which has materially improved the quality and efficiency of such reviews.

D. Management Techniques.

1. A branch bonus plan, initiated this year, is increasing the quality and quantity of filing reviews per staff year.
2. A procedure review system is presently being implemented to ensure high, uniform standards throughout the Corporation Finance Division.

E. Private Sector Self-Regulation.

Under the aegis of the American Institute of Certified Public Accountants and the oversight of Clarence Sampson, the SEC's Chief Accountant and his staff, the accounting firms that audit over 90% of publicly-owned companies are now on a three-year peer review cycle. These reviews provide better surveillance of accounting practices.

F. Research Forum.

The Commission recently held its first Research Forum at which leading securities analysts recommended improvements in the Commission's disclosure requirements and rulemaking practices. The staff is currently reviewing these recommendations with a view to simplifying and improving disclosures and public releases. Greater future input is also expected from the analysts.

II. Prevention and Suppression of Fraud.

Regulatory simplification places greater emphasis on enforcement activities. However, the following programs, initiated by Director John Fedders, Theodore Levine, Gary Lynch and other senior members of the Enforcement Division last year and in progress, are enhancing the effectiveness of the Commission's enforcement efforts.

A. Visibility.

Violations of the securities laws are inhibited by media reports of apprehensions, settlements and prosecutions. During the past fiscal year, such reports in the Wall Street Journal increased significantly.

B. Computerization.

The computerized Case and Activity Tracking System (CATS) and the Staff Time and Activity Tracking System (STATS) are improving enforcement case and personnel management. They permit senior management to monitor enforcement investigations and litigation throughout the nation, establish and administer priorities and improve productivity by early termination of marginal cases and redeployment of personnel. They also facilitate rapid response to inquiries and coordination with other law enforcement agencies.

C. Private Sector Self-Regulation.

At the Commission's initiative and under its oversight, the exchange and over-the-counter Self-Regulatory Organizations (SROs) are enhancing their electronic intermarket surveillance systems and audit trails, which permit the quick identification of possible manipulation and insider trading activities. The New York Stock Exchange's "Stock Watch" operation has received wide publicity, which inhibits such activities.

D. Coordination.

The Enforcement Division is also improving its effectiveness through closer coordination of the Commission's enforcement attorneys and investigators with the Self-Regulatory Organizations, the state securities regulators, the Justice Department and other domestic and foreign law enforcement agencies.

E. Swiss Accord.

The widely publicized Accord concluded with Switzerland last year removed the haven of the Swiss secrecy laws from those who would trade on inside information. The Swiss banks are sending notices to their clients throughout the world. Such publicity and notices inhibit insider trading.

F. Exemptions.

In accord with the Small Business Investment Incentive Act of 1980, last year the Commission expanded the exemptions of issuers (to exclude companies with less than $3 million of assets) and of offerings (of less than $5 million to other than the general public). These measures reduced the universe of potential reporting violations under the Commission's jurisdiction. The foregoing will continue to be subject to antifraud enforcement.

III. Supervision and Regulation of Securities Markets.

Continuing progress on the National Market System and a national clearance and settlement system are consuming significant staff time. However, the following programs initiated by Director Douglas Scarff and other senior members of the Market Regulation Division are enhancing the Commission's productivity.

A. Computerization.

1. New on-line computerized information systems are accelerating the staff's broker-dealer examinations.

2. These include automated data processing systems for analyzing broker-dealer records for churning and other violations.

3. Portable micro-computers are under consideration with a view to increasing the efficiency of the examination process.

B. SECO Program.

1. Over 85% of the nation's registered broker-dealers are being inspected and supervised by Self-Regulatory Organizations, under the oversight of the Market Regulation Division.

2. The remainder (known as SECO firms) are being inspected and supervised directly by the SEC.

3. Legislation proposed by the Commission would require the SECO firms to join a registered national self-regulatory organization, and relieve the Commission of this direct inspection and supervisory responsibility.

4. Since this legislation was proposed, SECO firms which employ over 80% of all SECO registered representatives have voluntarily joined a national self-regulatory organization.

5. This is enabling the Commission to devote greater resources to "for cause" broker-dealer examinations and SRO oversight activities.

C. New Rules and Procedures.

1. At the initiative of the Market Regulation Division, the Commission recently revised the issuer repurchase and underwriter market-making rules.

2. These revisions have reduced the time and expenses of providing interpretations and processing requests for exemptions and other relief.

D. Market Oversight and Surveillance System.

The SROs are enhancing their electronic intermarket surveillance systems and audit trails, under the oversight of the Market Regulation Division. This has enabled the Commission to begin converting its MOSS system to an audit mode.

IV. Public Utility Holding Company Regulation.

Since the basic objective of the Public Utility Holding Company Act - the dismantlement of the multi-tiered holding companies - was accomplished 20 years ago, the Commission has proposed repeal of the Act. In the meantime, Director Aaron Levy and Grant Guthrie of the Corporate Regulation Division, are streamlining the processing of regulated companies applications for approval of their financing, merger, acquisition and other plans. Next year, the Division will computerize this program in order to reduce the labor-intensive review of filings and improve the public's access to such information.

V. Investment Management Regulation.

Significant steps taken by Director Joel Goldberg, Richard Grant, Gerald Osheroff and other senior members of the Investment Management Division are increasing the Division's productivity and effectiveness.

A. Computerization.

1. Investment adviser inspections.

   a. The use of computers is permitting the staff to target those investment advisers which warrant more frequent inspections.

   b. They are also enhancing the staff's ability to predetermine the scope of the procedures to be used during periodic inspections.

2. Investment Companies.

   The Division is considering similar techniques which may be employed in investment company inspections during the coming year.

B. Money Market Fund Contraction.

1. Since December 14, 1982, when depository institutions were permitted to offer money market accounts, the money market funds have contracted by $38 billion (17%) and registrations filed by new money market funds have virtually stopped.

2. This reduction in the Division's workload is being offset to a slight degree by increased interest in equity and other traditional funds.

C. Paperwork Reduction.

1. Codification of Exemptions.

   During the past year, the Division proposed rules which would codify exemptive orders previously granted by the Commission. If adopted these will reduce the number of exemption requests.

2. Automatic Effectiveness.

   Other steps have been taken to expand the categories of documents submitted by registered entities which can be declared effective without staff review.

D. Self-Regulation.

1. Investment Company Directors.

The Commission has also reduced its paperwork by placing greater responsibilities on investment company directors.

2. Self-Regulatory Organizations.

The Commission has recently solicited public comment on various proposals concerning greater private sector involvement in conducting inspections. One proposal would involve the establishment of an SRO to conduct routine periodic inspections, under the oversight of the Investment Management Division.

E. Regulatory Simplification.

Public comments have also been solicited on concepts which would simplify the structure of investment companies, and reduce their expenses and the Commission's paperwork, but not investor protections.

VI. Legal Services.

The volume of litigation in which the Commission is involved continues to increase. However, efficiencies being introduced by General Counsel Daniel Goelzer, Paul Gonson, Russell Stevenson and other senior members of the Office of the General Counsel are increasing the staff's productivity and reducing its workload.

A. Computerization.

1. Legal Research.

Increasing usage is being made of Lexis, a computerized legal research system, for the preparation of appellate briefs and legal memoranda.

2. Computerized Index.

Commission appellate briefs are being indexed on the computer. Any member of the Commission's staff can rapidly retrieve prior General Counsel briefs on specific topics, without time-consuming research. Consideration is being given to adding General Counsel memoranda to this system.

3. Word Processing.

The Office of the General Counsel is now equipped with modern Lexitron word processing equipment. These memory typewriters have greatly increased the speed and efficiency with which briefs and other legal documents can be prepared.

4. Management Information.

Case and personnel management are being improved through the use of the computerized Case and Activity Tracking System.

B. Reduced Calendar Review.

The counselling group is spending less time reviewing calendar memoranda from other divisions. Its comments are being included in the divisional memoranda, before they are submitted to the Commission.

C. Discretionary Litigation.

1. Bankruptcy.

The Commission's participation in bankruptcy proceedings is discretionary. Only cases with significant potential benefits for investors are being entered.

2. Amicus Participation.

The Commission's amicus curiae participation in federal appellate proceedings is discretionary. The Commission is continuing to participate in leading cases.

VII. Economic and Statistical Research.

The reporting and review requirements of the Regulatory Flexibility and Paperwork Reduction Acts are time-consuming, but Director Jeffry Davis and other senior members of the Directorate of Economic and Policy Analysis are improving DEPA's productivity through the following programs.

A. Computerization.

New computer systems and programs have greatly enhanced DEPA's ability to collect, compile and analyze statistical data. Additional computer systems and programs are being developed.

B. Broker-Dealer Reports.

Approximately 5% of DEPA's personnel resources are devoted to the compilation, review and editing of data provided in broker-dealer reports. DEPA has begun to shift this program to the SROs.

C. Financings.

Approximately 14% of DEPA's personnel resources are devoted to the collection, compilation, editing, production and dissemination of securities registrations and private placement statistics. Consideration is being given to turning this program over to responsible vendors who would provide the information to the public at a reasonable cost.

D. Economic Staff.

1. The staff economists' ability to conduct timely in-depth analyses is being enhanced through the use of computer systems and programs.
2. Existing data bases of market and economic activity which will eliminate the need to develop such data in-house are also being explored.

VIII. Program Direction.

Productivity innovations now underway, initiated by Executive Director George Kundahl, Kenneth Fogash and the heads of the support offices, will improve administrative services and the efficiency of Divisional and Regional Office programs.

A. Computerization.

1. The Office of Information Systems is expanding the use of software available to user divisions and offices so that they can design their own output reports with little or no assistance required from the ADP staff.
2. The divisions and regional offices are being provided micro-computers to assist in case preparation and litigation.

3. In fiscal 1984, portable micro-computers will improve the capability and efficiency of on-site examinations of regulated entities, standardize inspections and facilitate report writing.

4. The recently automated central personnel data files enhance the Personnel Office's ability to conduct personnel evaluations, determine compliance with OPM directives, and respond to requests for personnel data. Development of software to perform retirement calculations and related services regarding employee benefits will increase the office's productivity.

5. The Comptroller is expanding automation of certain financial management functions which will expedite accounting and budgeting operations.

6. An automated procurement system will permit the Office of Administrative Services to increase the efficiency of tracking purchase orders, modifying contracts, and generating procurement reports.

b. Headquarters Consolidation.

1. Fiscal 1982 results suffered from the usual disruptions of the major move of the Commission's headquarters to a new location.

2. Consolidation of the headquarters in a single building has eliminated the need for time-consuming shuttle services and special messengers between dispersed locations.

C. Training.

The Commission is conducting annual training programs and conferences in each of its five principal program areas to improve the coordination between headquarters and regional staffs, thereby contributing to overall productivity and effectiveness.

D. Printing.

The transfer of the responsibility for printing, collecting and disseminating publications, such as the SEC Docket, SEC News Digest, Commission releases, and the SEC Decisions and Reports, to private vendors has reduced the workload demands on the Commission's printing plant and the Divisions and Offices which previously compiled and edited these materials.

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The foregoing amplifies previous statements (before the Senate and House Appropriations Committees and the House Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce) as to why I believe the Commission can maintain its present levels of activity, despite a 6% personnel reduction in fiscal 1984. Whatever Congress decides, the other Commissioners, the staff and I will continue to do our best to administer the securities laws effectively.

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